

# NAVAL POSTGRADUATE SCHOOL

## Monterey, California



### THESIS

**THE MISSING PIECE OF ACQUISITION REFORM:  
ECONOMIC INCENTIVES**

by

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December 1999

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**THE MISSING PIECE OF ACQUISITION REFORM: ECONOMIC  
INCENTIVES**

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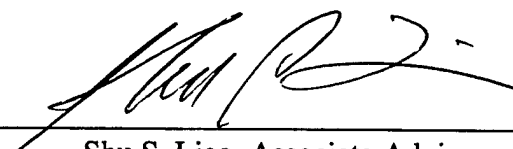


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## **ABSTRACT**

This thesis explores the role of economic incentives in the Federal bureaucracy and the impact these incentives have on achieving and sustaining acquisition reform initiatives. The thesis uses economic theory to demonstrate that Government bureaucrats act in their own self-interest to maximize their agencies' budgets, and have little or no incentive to reduce costs. Previous DoD acquisition reform efforts minimized or ignored the overarching importance of these incentives while attempting to treat the symptomatic problems. The National Performance Review has attempted to incorporate incentive structures by decentralizing decision-making authority and fostering initiative and innovation in the Federal workforce. The NPR's politically expedient focus on cost savings and personnel reductions, however, has undermined its ability to gain support among Government employees who perceive no tangible economic gain from embracing these reforms. New Zealand has implemented a comprehensive public sector reform program that emphasizes and incorporates economic incentives in the organizational structure, including decentralized resource allocation authority and accountability. Though the United States' political and bureaucratic systems create significant obstacles to adopting a comparable program, it is in the Country's best interest to incorporate economic incentive structures and accountability features within existing strategic management programs.



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## **I. INTRODUCTION**

### **A. BACKGROUND**

Though the Federal Government has procured goods and services for national defense since the beginning of the Republic, major structural and statutory changes started with the country's involvement in World War I. This war was the first national mobilization, and it exposed significant weaknesses in the Government's procurement methods. This initial effort started a cyclical pattern of DoD acquisition reform initiatives throughout the 20<sup>th</sup> century, re-gaining momentum during or after major increases in defense spending: World War II, the Cold War, Vietnam and the Reagan Administration's defense build-up. The latest reform efforts started in the late 1980s and early 1990s as the defense drawdown and budget cuts gained momentum, and the Clinton administration expanded these efforts in 1993 as part of the National Performance Review (NPR), an ambitious and expansive Federal Government reform program under the direction of Vice President Al Gore.

## **B. PURPOSE**

The purpose of this thesis is to provide an overview of past acquisition reform programs since World War II and their relative success or failure in meeting their intended goals. This overview will follow with an analysis of the current reform efforts, and what, if anything, senior acquisition executives and Congress can do (or not do) to successfully sustain current reform efforts within the acquisition workforce. The NPR has led to some significant policy and regulatory changes that have resulted in tangible improvements in the way DoD procures weapons systems, materiel, supplies and services. Sustaining and enhancing these improvements, however, once the "key players" of the reform movement leave is an obvious uncertainty that casts a pall over its recent apparent success.

One of the underlying principles of economics is the importance of incentives in affecting people's behavior and actions. A critical omission in the discussions and analyses of acquisition reform is the presence and/or absence of economic incentives among (1) Government acquisition executives and managers, and (2) the acquisition workforce itself, to sustain the acquisition reform efforts. Understanding these incentives could allow decision-makers to more accurately define the acquisition reform goals, and

use these goals as quantifiable measures of success now and in the future.

### **C. RESEARCH QUESTIONS**

#### **Primary Research Question:**

What incentives currently exist (intentional or not) within DoD that hamper or assist acquisition reform efforts?

#### **Secondary Research Questions:**

1. How does the unique nature and status of governmental organizations affect the ability to instill commercial/pseudo-competitive business practices in these organizations?

2. Can the Government establish incentives within the Federal bureaucracy to motivate DoD acquisition professionals to sustain acquisition reform initiatives?

### **D. METHODOLOGY**

The methodology of this thesis is to provide an overview of past and current reform efforts, using as its basis the economic theory of government/bureaucratic



organizations. This overview starts from the post-World War II era, since this period includes the major policy change of maintaining a large standing peacetime military, and the resultant rise of the defense industry. This overview includes library and Internet literature reviews comprised of both Government and private reports/evaluations. This thesis also includes a review of current civil service reform efforts in New Zealand to compare and contrast this system with that of the United States. Finally, this thesis uses data from various studies and surveys as a means of measuring motivational effectiveness and other pertinent trends in the acquisition reform efforts.

#### **E. ORGANIZATION OF THE RESEARCH**

##### **Chapter II. Economic Theory of Government Bureaucracy and the Role of Incentives**

This chapter provides the theoretical foundation for this thesis, using the writings and theories of William Niskanen, a respected economist who specializes in the study of public bureaucracies and organizations. This positive analytical framework demonstrates the overarching importance of incentives in the Federal Government's decision-making processes.

### **Chapter III. Past Acquisition Reform Efforts**

This chapter provides an overview of the post-WWII acquisition reform efforts, including the Hoover Commission Reports, the McNamara Era, the Packard Initiatives, the Carlucci Program, and the Packard Commission. This overview includes the factors that drove these efforts, their goals and their relative failure or success in achieving these goals. This chapter focuses on the incentive structures inherent in Government bureaucracy that have played such a critical role in the life of these reform efforts.

### **Chapter IV. Acquisition Reform in the National Performance Review (NPR)**

This chapter covers the Department of Defense acquisition reform initiatives under the NPR, including the goals, measures of success, results and incentive structures (intentional and unintentional) that have driven the implementation and sustainability of these initiatives.

### **Chapter V. Government Personnel Reform Efforts and Acquisition Reform**

This chapter gives a brief history of the U.S. Civil Service, an overview of recent reform efforts, and the

importance of the underlying incentives in the DoD acquisition workforce against the backdrop of past and current acquisition reform efforts. This chapter uses New Zealand civil service reforms as a benchmark and as a basis for analysis of the U.S. reform efforts.

## **Chapter VI. Conclusions and Recommendations**

What can the Government do to make acquisition reform improve and grow?

## II. ECONOMIC THEORY OF BUREAUCRACY AND THE ROLE OF INCENTIVES

### A. INTRODUCTION

This chapter provides the theoretical basis for this thesis, relying heavily on the writings of William Niskanen, a respected economist who specializes in the study of public bureaucracies and organizations. This positive analytical framework demonstrates the overarching importance of incentives in the Federal Government's decision-making processes.

Dr. Niskanen noted that "[t]he [then] current models of the bureaucracy are most defective in their failure to recognize that the behaviour of bureaucrats and bureaus is primarily determined by the *incentives* and *constraints* specific to the bureaucracy." [Ref. 24:p.4] To fill this gap in economics, he developed an alternative model of the behavior of governmental entities that is directly analogous to economic theories of the firm and the resultant basis of the theory of market supply. [ibid.:p.7]

## **B. THE ECONOMIC MODEL**

Dr. Niskanen's theory of supply by bureaus contains three major elements: (1) the distinguishing characteristics of bureaus, (2) the nature of the relations between bureaus and their environment, and (3) what the bureaucrats are trying to maximize. [Ref. 24:p.7]

### **1. Characteristics of Bureaus**

#### **a. Definition**

"Bureaus are non-profit organizations that are financed, at least in part, from a periodic appropriation or grant" [ibid.:p.8] and have both of the following characteristics:

1. Their owners and employees do not appropriate any part of the difference between revenues and costs as personal income.
2. Some part of the recurring revenues derives from other than the sale of output at a per-unit rate.[ibid.]

#### **b. The Product of the Bureau**

"Bureaus specialize in providing goods and services that some people prefer in larger amounts than

would be supplied by their sale at a per-unit rate, e.g. defense"[Ref.24:p.8] These people show their preferences by moving into a political domain and allowing the political entity (through voting) to tax them to provide these particular goods and services.

High fixed costs of production or difficulties in collecting fees characterize many of the goods and services supplied by bureaus. Therefore, "bureaus will most likely have a comparative advantage in the supply of services for which it is difficult to define (and contract for) output and during periods, such as civil crisis and war, when objectives are more nearly consistent throughout the government."[ibid.:p.11]

### ***c. Characteristics of the Bureaucrat***

The economist Anthony Downs noted, "[b]ureaucrats...are neither more nor less efficient, honest, hard-working, thorough, [and] public-spirited...than non-bureaucrats."[Quoted in Ref.24:p.12] Niskanen stated, however, that bureaucrats have differentiating characteristics that attract them to the implicit and explicit reward system of a bureaucratic organization, just as individuals in other professions have different

characteristics that define their attraction to their vocation.[ibid.]

It is a national pastime to speak disparagingly of Government workers and blame them for the real or perceived deficiencies in the resource allocation and decision making processes of the Federal Government. Though Niskanen and Downs may disagree on the capabilities and attitudes of those individuals in bureaucratic organizations, the important point that both economists are emphasizing is that civil servants are normal human beings responding to the incentives (perceived awards) provided them and restrictions imposed upon them by the bureaucratic organization.

## **2. Bureaus and their Environment**

### ***a. The Sponsor***

The Sponsor is a collective agency (i.e., Congress) that finances the activities of the bureau and whose officers "...review the bureau's proposed activities and budget, approve the budget, monitor the methods and performance of the bureau and, usually, approve the appointment of the bureau head"[Ref.24:p.13]. Niskanen characterizes this relationship as a bilateral monopoly, in

which the bureau has a dominant position for the following reasons:

1. The bureaucrat has much greater information on the costs and production processes of his or her organization than do the sponsors (i.e., Congressmen).
2. The bureaucrat has a much greater incentive to obtain more information pertaining to his or her position and organization, while the sponsors have conflicting and time-consuming demands that limit their ability to obtain similar information. [ibid.:p.16-17]

Niskanen assumes in the initial stage of this theory that the sponsor's role is passive: it (the sponsoring organization) controls the formulation and approval of the budget but does not have the incentive or the time to collect the information necessary to quantify the minimum cost of providing a given service or level of service within the bureau.

#### ***b. Market Factors***

Niskanen states that national bureaus (most pointedly the military) can practice wage and price discrimination because of the following factors:



1. The bureau's monopoly power over resources that derives from its status as a monopsonist (single buyer), primarily in the labor market. This market power stems from the inelastic labor supply curves that personnel such as infantry officers and naval surface line officers face in viewing their alternative employment opportunities in the private sector.

2. The use of specialized resources for which the Government has prior claim in the public domain: land, airspace, electronic frequency spectrum, nuclear materials and (during the military draft) young men. [Ref.24:pp.18-19]

This wage and price discrimination capability was probably more relevant when Niskanen developed this theory in the early 1970s than it is now, since DoD's current share of Government spending and, by extension, its share of GDP, is significantly less. For example, in Fiscal Year 1971 DoD's budget was 35.4% of the total Federal Budget and 6.9% of GDP; in Fiscal Year 1999 these figures were 15.3% and 3.0%, respectively. [Ref. 31] In addition, the inability of the military services to attract and retain field-grade officers (O-3 and O-4 paygrade) during the 1990s casts doubt on Niskanen's premise that these officers' unique skills

essentially made them "beholden" to their respective employers.

### **3. What do Bureaucrats Maximize?**

Niskanen takes exception to the traditional depiction of the bureaucrat as a selfless individual who subordinates his or her self-interest to the best interests of the Government/populace. He instead builds upon the economic theory of the (private) firm - and its assumption of profit-maximization as the primary motivator of behavior - to argue that an analogous *budget-maximizing* behavior exists among the public-sector bureaucrats, based on rationality and survival, and constrained by the output expectations of the Sponsor.

#### **a. Rationality**

Niskanen uses the following example to underscore the first factor in his postulate of bureaucratic economic behavior:

The rationality of budget maximization by bureaucrats may be best illustrated by considering the consequences of contrary behavior. Consider the probable consequences for a subordinate manager who proves without question that the same output could be produced at, say, one-half the present expenditures. In a profit-seeking firm this manager would probably receive a bonus, a promotion, and an opportunity to find another such

economy; if such rewards are not forthcoming in a specific firm, this manager usually has the opportunity to market his skills in another firm. In a bureau, at best, this manager might receive a citation and a savings bond, a lateral transfer, the enmity of his former colleagues, and the suspicion of his new colleagues. Those bureaucrats who doubt this proposition and who have good private employment alternatives should test it...once.[Ref. 24:p.23]

Niskanen goes on to state that this assumption of budget maximization is not based on any negative or cynical evaluation of the personal motivations of Government employees. Rather, even the most public-spirited and altruistic bureaucrat cannot collect and assimilate all the information necessary to determine the optimal resource allocation and production decisions necessary to maximize the well being of the populace. This model bureaucrat may, in fact, have a different opinion or perception of what does maximize the general welfare from that of his peers, superiors or the Sponsor, and he or she may not have the authority to make any substantive changes to the resource allocation mix, anyway. Therefore, it is impossible for a single bureaucrat to act in the "public interest", because of the limits on information and the conflicting interests of others, regardless of his or her personal motivations. [ibid.:pp.22-23]

At first glance this statement about the "model" bureaucrat appears to contradict the earlier quote illustrating the disincentives confronting the bureaucrat to cut costs/expenditures. Niskanen argues, however, that these information limits and interest conflicts lead the bureaucrat to choose some feasible, lower-level goal or interest upon which he builds his expertise. This expertise development, in turn, generates a sense of dedication that underscores his *perception* of what constitutes the public interest. This perception motivates the bureaucrat to become a budget maximizer for his program or agency, compounded by the external and internal incentives discussed in the next section.[Ref. 24:p.23]

#### ***b. Survival***

Niskanen uses this survival argument to complement the rationality argument discussed in the previous section. He discusses the impact that subordinates can have on the bureaucrat's budget-maximizing behavior through (1) their support of or opposition to the agency's policies, and (2) their outlook on employment security and promotion opportunities that they perceive are tied directly to changes in the bureau's budget. Niskanen contends that the strongest motivational factors, however, come from the

sponsors (Congress and the Executive Branch leaders): The oversight officials expect the bureaucrat/agency head to propose more activities and more funding for his activities and functions. [Ref. 24:p.25] This phenomenon occurs because the sponsor(s) do not have the resources necessary to research the existing programs and activities and propose new ones, so they expect the bureaucrats to act as informed advocates in their stead. This allows the sponsor to assimilate the marginal (incremental) changes without being overwhelmed by the enormity of the programs as a whole.

Military supply and finance officers can attest to this inculcated mindset when they submit their proposed budget figures for the next fiscal year: If they aren't asking for more, then the perception exists that they aren't supporting their commands and are negatively affecting the combat readiness of the organization.

### ***c. Constraints on Budget Maximization***

The constraint that ultimately limits the size of bureaus is that, on average, they must supply the output expected by the sponsor on its approval of the budget. The bureau that consistently underperforms will most likely face reduced funding in the future, though some contemporary examples seem to refute this statement (e.g., the CIA and

its increased funding despite some recent embarrassing slip-ups). Conversely, a bureau that performs better than expected will most likely receive increased funding. One must wonder how the U.S. Congress defines and quantifies "better than expected performance" when evaluating the numerous and diverse functions of the Federal Government bureaucracy. This issue is addressed in Chapter V as it pertains to the Department of Defense.

In summary, the central motivational assumption of Niskanen's theory of supply by bureaus is as follows: Bureaucrats maximize their budget during their tenure, subject to the constraint that the budget must equal or exceed the minimum total costs of supplying the output expected by the sponsor. [Ref. 24:p. 27]

### **C. CONCLUSION**

Niskanen's most important general conclusion from his theory of supply of bureaus is that they are too large. The corollary to this conclusion is that there is no incentive for bureaus to produce goods or render services at the lowest possible cost. The interested reader can refer to the cited reference for a graphical illustration of this conclusion.[Ref. 23] For given demand and cost conditions, both the budget and output of a monopoly bureau may be up to

twice that of a competitive industry facing the same conditions. [Ref. 24:pp.33-34]

What drives this inefficient outcome? Answer: the incentives confronting the bureaucrat when he is attempting to maximize his own economic self-interest. In general, a Government official does not enhance his career prospects by recommending budget cuts, program cancellations and personnel reductions.

The economist Charles Schultze stated that "Harnessing the 'base' motive of material self-interest to promote the common good is perhaps the most important social invention mankind has yet achieved." [Ref. 27:pp.53-54] This comment was not directed at the issue of bureaucratic self-interest and economic incentives, but it is relevant. The challenge for the advocates of acquisition reform (i.e., the "common good" in this case) is to channel this self-interest among the members of the bureaucracy to create a self-sustaining force. It remains to be seen if they can actually achieve this very difficult task.

The following chapter provides an overview of the post-WWII acquisition reform efforts, the factors that drove these efforts, their relative failure or success in achieving their stated goals.

### III. PAST ACQUISITION REFORM EFFORTS

#### A. INTRODUCTION

This chapter provides an overview of the post-WWII acquisition reform efforts, including the Hoover Commission Reports, the McNamara Era, the Packard Initiatives, the Carlucci Program and the Packard Commission. This overview includes the factors that drove these efforts, their goals and their relative failure or success in achieving these goals. This chapter focuses on the incentive structures inherent in Government bureaucracy that have played such a critical role in the life of these reform efforts.

The reports and initiatives discussed in this chapter are only a few of the many reform efforts that have become almost commonplace since World War II. Some of these efforts were comprehensive reviews of the whole Federal Government (e.g., the Hoover Commissions), while others were focused solely on DoD procurement policies (McNamara). Omitting the other studies, reports and initiatives does not "skew" the analysis one way or the other. In the author's professional judgment, there is little value added by including these other programs in this paper; the cogent points would be so redundantly overstated that they would



lose their impact on the reader. As the political scientist Paul C. Light stated in his book *Thickening Government*,

[I]t is quite reasonable to argue that the problem...is not that there has been too little reform over the years, but too much; not that too many commission reports are allowed to gather dust on long-lost library shelves, but that too many poorly formed ideas pass into statute. As a result, government lurches from one reform philosophy to another...without ever dredging out the old reforms and the hierarchy that comes with them. [Ref. 20:p.34]

For further ease of clarity the timeline starts in the post-World War II era. The rationale for this decision lies in the fact that the late 1940s marked the beginning of the modern defense industry, the Government's decision to maintain a large peacetime military force, and the advent of increasingly complex weapons systems.

## **B. POST-WORLD WAR II PERIOD**

### **1. The Hoover Commission Report (1947-1949)**

Congress created the first Hoover Commission with the full support of President Truman to conduct a comprehensive review of the organizational and managerial structure of the Federal Government. The impetus for this review was the dramatic growth of Government since the 1930s, including a

fourfold increase in the number of civil employees and Federal agencies, and annual expenditures that had increased by a factor of ten over 20 years. [Ref. 14:p. xiv] This unprecedented growth, in turn, raised concerns that the executive branch had become too large and unwieldy, a belief fully endorsed by the Commission:

This Commission has found that the United States is paying heavily for a lack of order, a lack of clear lines of authority and responsibility, and a lack of effective organization in the executive branch. [ibid.]

Chairman Herbert Hoover, however, purposely chose to limit the Commission's purview to that of how the Government should operate (i.e., how can the existing structure maximize efficiency and economy?), rather than expanding the scope to evaluate what the Government should do (i.e., should the Government carry out these activities and functions?). He made this decision because of the vague objectives and lack of directional guidance in the enabling legislation. [Ref. 21:pp.9-10] This issue would be an important one in the 1990s version of the Hoover Commission, the National Performance Review (NPR), as the next chapter will show.

In the area of "Supply Administration", as the Commission called it, the major deficiencies included the following factors:

1. Overregulation of the procurement process, with the focus on fraud prevention rather than efficiency and economy. The Commission estimated that the administrative cost of over half of the three million purchase orders issued by procurement activities was greater than the cost of the items purchased.
2. Poor or non-existent acquisition planning and inadequate control over supply expenditures, including the ubiquitous end-of-the-fiscal-year spending sprees.
3. Failure to recruit, train, and retain personnel in the procurement field, including the lack of professional status.
4. Tight regulation of some procurement activities and functions that stifled innovation and created inefficiencies; insufficient oversight of other activities and functions.
5. Inadequate Government data collection processes necessary to conduct budget planning and perform informed managerial decision-making. [Ref. 14:p. 97]

These valid deficiencies will become recurring themes in all the reform initiatives (and a reader of history will note that the Hoover Commission was not the first to discern these problems).

What was the Commission's prescription for fixing these systemic problems? Paul Light noted that the "...cure [was] one of centralization, limited spans of control, and more hierarchy" which was based on the prevailing organizational theory of "scientific management".[Ref. 20:p.39] Congress did, in fact, ultimately adopt most of the Commission's 14 supply operations recommendations, including enhancing the authority of the Secretary of Defense over the individual military services.

It is difficult to evaluate how effective these reforms were on the DoD procurement bureaucracy, primarily because the Korean War started the following year and shifted the focus away from reform efforts to meeting the logistics requirements of a nation at war. Any savings gained from the implementation of these recommendations were purely speculative. One interesting outcome, however, of the Commission's recommendations on increasing hierarchical control of the bureaucracy was the 207% increase in senior

appointed officials during President Eisenhower's administration, including DoD.[ibid.]

## **2. The (second) Hoover Report (1953-1955)**

The first Hoover Commission was limited in its purview to that of reviewing how the Federal Government was operating; it did not evaluate the scope of its functions and policies. The second Hoover Commission, however, received a charter from Congress to investigate the full scope of the Government, ostensibly to build upon the "success" of the first Commission and because of the additional growth of the Federal Government resulting from the Korean War build up.[Ref. 21:p.10]

The Commission presciently stated in the preface to its report that:

The genius of the private enterprise system is that it generates initiative, ingenuity, inventiveness and unparalleled productivity. With the normal rigidities that are a part of Government, obviously, the same forces that produce excellent results in private industry do not develop to the same degree in Government business enterprises. Because of vested interests, misleading or incomplete accounts, or other reasons, some of these enterprises set up to meet war or economic crises 'established an astonishing longevity.' [ibid.:p.15]

Based on this unqualified endorsement of the incentive structures intrinsic to the free enterprise system, one

would think that the Commission would base its analysis of Government operations and functions on this same premise. In reality, the Commission ignored the overarching importance of incentives.

Instead, the Commission faulted the "outmoded systems of administration" for the waste, inefficiency, duplication of effort and lack of coordination it found in the DoD. [Ref. 21:p.259] The Commission correctly noted that these shortcomings were not the fault of the individual officials, but then directed the blame to the rapid military buildup, "defects of tradition", outmoded laws and other systemic problems.[ibid.]

The Commission's recommendations for correcting the institutional problems of DoD sounded very similar to those of the first Hoover Commission:

1. Improving the organizational framework, enhancing civilian control (a recurring theme of this Commission), improving support structure organization and providing greater opportunities for "executive teamwork".
2. Integrating common supply and service activities.
3. Increasing tenure, motivation, and skill of both civilian and military executives.

4. Establishing better financial control in DoD, enhancing control of top management and improving operational effectiveness.[Ref. 21:p.260]

These and the other 314 recommendations of the second Hoover Commission would, in the words of the report itself, "bring greater efficiency...into the Government...[and] retard, if not halt, the steady trend toward Big Government...."[ibid.:p.310] As noble as these sincere words sound, informed observers know that these recommendations (65% of which were statutorily implemented by Congress) made little impact on enhancing the efficient operations of DoD, stopping the growth of Government in general and instilling the incentives necessary to achieve and sustain these very laudable goals.

#### **C. THE MCNAMARA ERA**

Robert McNamara, a former Ford Motor Company executive, became Secretary of Defense in 1961. He assumed this position in an environment driven by three major factors: (1) the 1950s had seen a dramatic increase in the cost and complexity of major weapons systems; (2) the individual military services ran their own acquisition programs with little or no interference from the Office of the Secretary of Defense (OSD); and (3) in 1958 Congress had finally acted

upon the first Hoover Commission's recommendation to grant OSD oversight authority of all the major weapons systems. [Ref. 5:pp.12-13 & p.42; Ref. 7:p.3] Armed with the statutory authority, McNamara seized the opportunity to implement management changes and formalize a DoD acquisition policy.

McNamara's management philosophy can be characterized as a "decision pyramid":

The aim was to push all decisions to the lowest appropriate level. The top levels simply provided a framework to ensure that decisions were consistent.... Applying this philosophy to DoD procurement, McNamara felt that the Services should develop the alternatives to be considered; OSD should make the choices between alternatives. To implement this approach, OSD needed mechanisms to force alternatives to the surface, procedures to analyze them, and staff to conduct the analyses and made the decisions. [Ref. 7:p.3]

This greater emphasis on quantitative analysis led to the implementation of a number of management tools:

1. The Planning, Programming and Budgeting System (PPBS) which is still in use today, and provides the Secretary of Defense and the President with an organized approach to major program decisions and allocation of resources.



2. The Five Year Defense Plan (now the Future Year Defense Plan), which projects the implications of today's decisions on future defense budgets.

3. The use of fixed price and incentive fee contracts to motivate the defense industry to reduce the cost of major weapons systems.

This list is by no means an exhaustive one, and many of the management reforms and programs created by McNamara are still in use today (the Defense Contract Management Command, the Defense Contract Audit Agency, the Defense Logistics Agency, Integrated Logistics Support planning procedures, to name a few).

With the dye cast in terms of quantitative analysis and improved managerial decision-making, why was there not a marked improvement in DoD's acquisition processes? Simply because the record shows that reforms - which did improve the managerial capabilities of the DoD acquisition bureaucracy - did nothing to improve the incentive structures running so pervasively throughout DoD. J. Ronald Fox, an acknowledged expert of the defense acquisition process, stated that programs such as the C-5A, the F-111 and the F-14 incurred major cost overruns because of DoD-driven program changes and because of DoD's unwillingness or inability to enforce the fixed price contracts. [Ref.

5:p.43] Lauren Holland supports this contention in her Spring 1998 *Acquisition Review Quarterly* article on acquisition reform.[Ref. 13:pp.235-253] From the Government acquisition executives' and program managers' perspectives there was little gained by "holding the contractor's feet to the fire", because their own self-interest dictated that it was more important to get the weapons systems completed than curtailing the cost overruns.[Ref. 2:pp.190-192]

#### **D. THE PACKARD ERA**

David Packard, co-founder of Hewlett-Packard, took office as Deputy Secretary of Defense in 1969 under the Nixon Administration. Along with Secretary of Defense Melvin Laird, he was determined to improve the DoD acquisition process, an issue that gained additional urgency as the defense budget declined significantly as part of the disengagement from the Vietnam War. Professor Bill Gates of the Naval Postgraduate School summed up the environment of the time very succinctly:

...the generally acknowledged problems in the Defense sector included: *excessive centralization* (italics added); alleged inefficiencies in the acquisition process (i.e. cost growth); and a separation between decision making authority, responsibility for implementation, and accountability for the resulting outcome. The resulting symptoms included cost growth, schedule delays, and technical performance shortfalls;

poorly defined programs; and increasing mistrust between DoD and the contractors.[Ref. 7:p.4]

Laird and Packard felt the increased data requirements and management oversight that McNamara introduced had not resolved the earlier problems or their symptoms. Instead, McNamara's policies had simply increased the management layering, made the acquisition process more complex, and separated decision making authority, responsibility and accountability. Laird and Packard also thought the appropriate response was to decentralize and streamline the acquisition process, increase program manager quality, improve the requirements setting process, increase hardware testing (e.g., prototyping and "fly-before-you-buy"), and improve cost estimating procedures.[ibid.]

Packard established a series of policy goals for major weapons systems acquisitions that ultimately evolved into the DoD 5000 series Directive and Instruction, the centerpieces of DoD acquisition policies and procedures. A key element of these policies was to give program managers sufficient authority to make major decisions, recognize and reward them for good work, and improve their career opportunities.[Ref. 5:pp.44-45]. Despite the potential benefits these changes could achieve (at least in the short run), the military services refused to change their

promotion and assignment policies that emphasized and rewarded operational experience at the expense of program management and other acquisition-related career paths.

During the Packard Era, a congressionally appointed Commission on Government Procurement presented the following findings and recommendations:

1. Congress was ill equipped to evaluate performance, costs, and schedules for new defense systems programs in the context of national security objectives and priorities.
2. Congress should establish an Office of Federal Procurement Policy, to be headed by a presidential appointee, to oversee Federal procurement policies throughout the Government.
3. Congress should consolidate all statutory procurement regulations into a single statute.
4. DoD should upgrade the acquisition workforce by establishing an institution to provide necessary education and services.
5. DoD should reduce the management and administrative layers between policy makers and program offices.
6. Congress should have greater visibility in the acquisition process to exercise its responsibilities, i.e., provide the information

needed to make key program decisions and commitments.[Ref. 7:pp.45-46]

Congress and DoD did eventually adopt some of these recommendations, though others - such as reducing layers of management - ran counter to the institutional incentives that pervade public organizations and bureaucracies. The reader may also note that these recommendations sound very similar to those of the Hoover commissions, which should come as no surprise given these same underlying incentives.

Even a successful and intelligent person like David Packard did not understand the incentive structures driving the behavior of DoD officials and the military services:

As sensible and constructive as Deputy Secretary Packard's initiatives were, there were significant cost increases in weapon development and production programs during the 1970s...[and] near the time of his departure, he expressed disappointment at [DoD's] resistance to improvements in the acquisition process.... Mr. Packard and his predecessors during the McNamara tenure assumed that the military and civilian career development systems would provide sufficient people with the required skills in industrial management.[ibid.:p.46]

In hindsight, Mr. Packard should be applauded for his concerted effort to reform the acquisition process, but one must also wonder if he understood how difficult (if not impossible) it would be to effectively transfer private sector business practices to Governmental entities without a

simultaneous change in the incentive structures driving DoD decision-making processes.

#### **E. THE CARLUCCI INITIATIVES**

Frank Carlucci became Deputy Secretary of Defense in 1980, and remained in this job when President Reagan's administration took office in 1981. The problems facing him and his boss, Caspar Weinberger, were no different than those of the past: cost growth, schedule delays, and performance shortfalls. Weinberger and Carlucci instituted yet another set of reforms to address the concerns of the major players in the defense acquisition process: Congress, OSD, the military services, and the defense industry. The 31 Carlucci initiatives (later expanded to 32 at the behest of Congress) prescribed the following reforms:

- more multi-year procurement contracts
- greater competition in contracting
- increased program stability (i.e., predictable and consistent funding and management support)
- improved management principles
- improved forecasting and information
- improved support and readiness
- more realistic budgeting

- more fixed price contracting
- reduced Federal acquisition bureaucracy [Ref. 5:p.47; Ref. 7:p.6]

Congress codified its desire to enhance competition by enacting the Competition in Contracting Act of 1984, which allowed non-competitive ("sole-source") procurements under limited and documented circumstances only. [Ref. 7:p.7]

Anecdotal evidence and a GAO study called into question the impact of the Carlucci initiatives on DoD procurement practices. The Army's refusal to acknowledge the failures of the DIVAD program in the early 1980s despite overwhelming evidence was a profound example of the public bureaucracy's unwillingness to accept responsibilities for failed or unnecessary programs. After considerable stonewalling, Defense Secretary Weinberger cancelled the program. Why did the Army continue to support the DIVAD? Because doing so would call into question the effectiveness of all the other major weapons systems and adversely affect the career opportunities of the program's advocates (i.e., senior military officials and program managers). In 1986, GAO found over half of the program managers that it interviewed thought that the Carlucci initiatives had made little or no difference in the acquisition process. [Ref. 5:p.48] These

initiatives were another example of "nibbling around the edges" and failing to understand the core problems in the defense acquisition process.

Congress did not help the reform efforts by its dramatic increase in oversight and micromanagement. In 1984, reports of overpriced spare parts began filling the front-page sections of newspapers, and congressional members began to feel the pressure to "do something". By 1986,

an atmosphere of uncertainty, frustration, and apprehension pervaded the Pentagon and its contracting base, for each new day brought with it additional regulations and concerns that more errors would be uncovered by either the press or congressional auditors, investigators and overseers....[T]he logjam of procurement legislation awaiting implementation had become so great that Pentagon and defense industry officials pleaded with Congress for a moratorium on further reform legislation. Congress responded by appealing for greater professionalism....[ibid.:p.85]

Congressional members submitted almost 400 bills related to defense acquisition between 1984 and 1986. DoD responded to congressional pressure by issuing new regulations and instructions that only exacerbated the situation. The profusion of new laws, directives and instructions, combined with the limited training and experience of the personnel assigned to manage the acquisition process, meant that practices in the field were



usually different from the laws and regulations on the books.[Ref. 5:p.37]

#### **F. THE PACKARD COMMISSION**

In 1985 President Reagan appointed former Deputy Secretary of Defense David Packard to chair a blue ribbon commission whose job, in part, was to recommend improvements and reforms in the defense acquisition process. Not surprisingly, the Commission reported the same problems that David Packard had tried to tackle in the early 1970s: "[T]he defense acquisition process [is] expensive, inefficient and cumbersome." [Ref. 25:p.1] The reader should bear in mind that this commission was operating in a charged environment permeated by recriminations about price gouging and inefficiency. Laws and regulations were flying in at a record pace, and a significant portion of the acquisition workforce dealt solely with interpreting and implementing these changes.[Ref. 5:p.50]. Attempting to correct these problems, the Packard Commission recommended the following changes:

1. Create a new Under Secretary of Defense for Acquisition, who would be in charge of procurement, research, development, and weapons systems testing.

2. Create acquisition executives (AEs) in each service who would report to the new Under Secretary and to their respective service Secretaries.
3. Create program executive officers (PEOs) who would report to the AEs and oversee a group of program managers.
4. Give the Chairman of the Joint Chiefs of Staff more authority and create a vice-chairman, who, along with the new Under Secretary, would be part of a Joint Requirements Management Board (now known as the Joint Requirements Oversight Council) that would establish requirements for new weapons and approve or reject them at each step along acquisition process.[Ref. 25]

The Commission also recommended streamlining the acquisition process, increasing tests and prototyping, improving planning, and adopting biennial appropriations and authorizations. With the notable exception of the biennial budgeting idea, the President and Congress accepted the recommendations and incorporated them into the 1986 Defense Reorganization Act.[Ref. 7:p.7]

The Packard Commission recommendations were not significantly different from those that had emanated from

past reform efforts, so it would be reasonable to presume that they were equally ineffective. Unfortunately, but unsurprisingly, this presumption was true. A study of 269 defense acquisition contracts completed between 1988 and 1995 showed greater cost growth than 378 acquisition programs, comprising 1,843 individual contracts, during the 1977-1985 period.[Ref. 3:pp.251-258]

The political scientist Paul Light contends that the Packard Commission put more faith in establishing greater control and discipline in the acquisition process, at the expense of streamlining it. To buttress this argument, he quotes from the Commission's report:

[I]t is fundamental that we establish unambiguous authority for overall acquisition policy, clear accountability for acquisition execution, and plain lines of command for those with program management responsibilities.[Ref. 20:p.139-140]

Light may have a valid point, since the Commission was undoubtedly sensitive to the political realities of the day. Perhaps Packard and the other commission members felt that using a heavy dose of "command and control" would give DoD some relief from the seemingly continuous flow of legislative initiatives. Regardless, the reform suggestions yielded no discernable improvements in the acquisition process.

## G. CONCLUSION

The political scientist Lauren Holland succinctly sums up the thrust of these past acquisition reform efforts:

[R]eform efforts have focused primarily...on streamlining the weapons acquisition process, improving cost-estimating practices, and changing personnel procedures to produce more qualified contracting staff. Recommendations have included eliminating needless legal encumbrances on contracting procedures; empowering program managers; establishing clear lines of authority; simplifying the source selection process; reducing technical criteria; recodifying federal [procurement] laws; employing more frequent product testing and competitive prototyping; improving the pay, training, and career options for personnel; and multi-year congressional funding.[Ref. 13:p.235]

The fact that each and every one of these commissions and policy initiatives has essentially rehashed the same recommendations with little or no success suggests that these well-intentioned bodies have looked in the wrong areas. Professor William Gates contends that the increased emphasis on quantitative measures of program performance (i.e., cost growth, schedule delays, technical performance shortfalls) has elevated these performance measures from "proxies" to direct measures of program inefficiencies.[Ref. 7:p.7] In other words, the focus of the reforms has been on correcting the symptoms of the underlying problems in DoD procurement rather than determining the root causes

themselves. This focus also reflects the dictum, "what gets measured gets managed".

A predictable outcome of this attention to symptomatic performance measures is an increase in the number of players and viewpoints concerned with the acquisition process. This increased oversight, in turn, has "diffused" authority and accountability throughout the whole acquisition bureaucracy and among the political leadership. [Ref. 7:p.7; Ref. 20:pp.61-73] The result of this diffusion is increased incentives for principle players in the acquisition process to conduct risk avoidance and promote their own objectives at the potential expense of other interest groups.

The sheer volume of reform efforts over the years has numbed the military services and civilian DoD employees to a state of indifference.[Ref. 5:p.51] This disdain for reform initiatives reached its pinnacle in 1986 when Deputy Secretary of Defense William Howard Taft IV stated that DoD had already implemented all the Packard Commission recommendations one week after issuance of the Commission's report.[ibid.:p.133] No one really believed him, but what was going to happen to him? Taft - along with everybody else in DoD, the defense industry and all the other players in the acquisition process - knew that without sustained,

consistent leadership at the highest level, the Packard reforms would go the way of all the past efforts.

Besides this "familiarity (or frequency) breeds contempt" problem, the reformers faced the systemic incentives that undermined their quest for greater efficiency:

In government, a successful agency is expected to increase, not decrease, its budget year after year. Therefore, the "good people" are those that spend all the money allotted in one year and can justify an increase for the next year, while incurring the least amount of opposition.[Ref. 5: p.50]

What, in fact, was anybody going to gain by embracing these reforms? Their jobs were not in danger, and they wouldn't get a pay raise or promotion for implementing efficiency improvements that might eliminate their agency and, by extension, their job.

It was against this backdrop of indifference and unfulfilled expectations that President Bill Clinton embarked on the National Performance Review (NPR) in 1993.

The next chapter covers the Department of Defense acquisition reforms under the NPR.

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#### **IV. ACQUISITION REFORM IN THE NATIONAL PERFORMANCE REVIEW**

##### **A. INTRODUCTION**

This chapter covers the Department of Defense acquisition reforms under the National Performance Review (NPR), including the goals, measures of success, results and incentive structures (intentional and unintentional) that have driven the implementation and sustainability of these initiatives. The first part of this chapter covers the factors that led up to the NPR.

##### **B. THE GENESIS OF THE NPR**

The National Performance Review began on 3 March 1993, when President Bill Clinton announced a six-month review of the Federal Government and appointed Vice President Al Gore to lead it. The purpose of the NPR, in the words of the Vice President, was "to make government *work better and cost less*".[Ref. 9:p.i] To achieve this expansive and ambitious reform program, the NPR took the following actions:

1. Organized teams of experienced Federal employees to examine agencies and Government systems, including budgeting, procurement and personnel.



2. Asked cabinet members to create Reinvention Teams and Reinvention Laboratories to begin experimenting with new ways to do business.

3. Interviewed and solicited comments from Federal employees, business leaders, state and local Government leaders, and common citizens on their views, recommendations and experiences.[ibid.:pp.i-ii]

In November 1993 the Vice President submitted a report containing 384 recommendations that promised \$108 billion in savings and a 12 percent reduction in the civilian Federal workforce over the next five years. He also promised to make customer service one of the central tenets of the NPR.[Ref. 9:p.iii] It is interesting to note that the Vice President specifically stated that "the central issue we face is not *what* government does, but *how* it works".[ibid.:p.2]

In announcing the start of the NPR, President Clinton stated that

Our goal is to make the entire federal government both less expensive and more efficient, *and to change the culture of our national bureaucracy away from complacency and entitlement toward initiative and empowerment.* We intend to redesign, to reinvent, to reinvigorate the entire national government.(italics added)[Ref. 9:p.1]

It is not the intent of this thesis to analyze the administration's political motivations in carrying out the NPR, but suffice it to say that record-high budget deficits, the staggering national debt and the abysmally low public confidence in the Federal Government (campaign themes in the 1992 election) provided strong incentives to give the reform effort another try.[Ref. 16:p.2]

Regardless of its value as a political issue, it would be enlightening to understand the sources of ideas for the NPR. The Federal Government is not known for pioneering new management ideas and innovative practices, and the NPR is no exception. The Clinton administration drew its ideas from the 1992 book *Reinventing Government* by David Osborne and Ted Gaebler.[Ref. 20:p.235] Osborne and Gaebler concluded that ten principles formed the foundation for "entrepreneurial" government:

1. Steering rather than rowing
2. Empowering communities instead of merely delivering services
3. Encouraging competition rather than monopoly
4. Focusing on mission, not on rules
5. Funding outputs rather than inputs
6. Focusing on the needs of the customers, not the bureaucracy

7. Concentrate on earnings, not just spending
8. Investing in prevention rather than correction
9. Decentralizing authority
10. Leveraging the marketplace instead of creating public programs[Kettl, p.7]

Donald Kettl states that the Clinton administration found this concept of "reinventing" Government particularly attractive because it provided a way for strengthening and improving Government without increasing its size. It was a strategy based on the idea that Government and its programs were fundamentally good but needed to be improved.[Ref. 16:pp.7-8]

The NPR also used the experiences of corporate America to acquire ideas and strategies. In the late 1980s and early 1990s corporate reformers had worked hard to instill a customer focus in their employees, reengineer their operations, shrink their workforces and reduce the organizational layers-especially middle management. This period also marked the U.S. introduction of the principles of Total Quality Management (TQM), as espoused by W. Edwards Deming. These and other private sector reforms (driven by increasing foreign competition) provided the Government with a language for charting the reforms, an argument about why change was needed, and a template for action.[ibi.:p.10]

Finally, the NPR reformers drew sustenance from reform efforts in other countries. New Zealand implemented an aggressive program in 1984 (and still in place today) that is undeniably the most comprehensive overhaul of any government management system in the world. It exemplified the "new public management" movement that has swept through a number of countries: Australia, Sweden, Canada and the UK. [Ref. 16:pp.12-14]

The NPR undoubtedly borrowed and incorporated into its campaign innovative concepts from a diverse variety of sources. Kettl, however, describes the caveat to this process:

The NPR... eagerly took ideas like performance measurement, customer service, and performance-based organizations from New Zealand without carefully assessing whether they worked in their home countries, *what was required to sustain them*, how well they matched the American environment, and how easily they could be transplanted. (italics added) [ibid.:p.14]

This shortcoming would be a recurring problem for the NPR and will be addressed in more detail in later sections.

### **C. ACQUISITION REFORM UNDER THE NPR**

Prior to the advent of the NPR, the National Defense Authorization Act of 1991 created a new study group called the Section 800 Panel (formally known as the DoD Acquisition

Law Advisory Panel) whose purpose was to review, and recommend improvements in, Federal acquisition laws, regulations and procedures.[Ref. 12:p.21; Ref. 10:p.5] The NPR used the Section 800 report as the basis for its recommendations pertaining to the "reinvention" of the Department of Defense.

This thesis will not go into the details of all the NPR's procurement reform recommendations. The focus, instead, will be on some of the major changes that reflect the theme of the NPR.

### **1. Restructuring the Office of the Secretary of Defense (OSD)**

One of the first actions of the Clinton administration was to reorganize OSD ostensibly to "streamline [department] operations, ...build a new OSD to pursue post-Cold War missions, and undertake a new way of operating through a team approach".[Ref. 10:p.7] The goal of this reorganization was to enable the Secretary of Defense and upper DoD management to concentrate more on effective policy formulation rather than implementation.[ibid.]

The bureaucratic structure changed from 20 separate offices reporting directly to the Secretary to five primary operational units:

1. Acquisition and Technology
2. Personnel and Readiness
3. Comptroller
4. Command, Control, Communications and Intelligence
5. Policy

Specific to acquisition reform efforts was the creation of the office of the Deputy Under Secretary of Defense for Acquisition Reform.[Ref. 10:p.7] The purpose of creating this office was to give acquisition reform a highly visible "advocate" within DoD and act as a focal point for policy implementation and execution.

## **2. Statutory Changes**

The Federal Acquisition Streamlining Act of 1994 (FASA), Public Law 103-355, was a direct outgrowth of the NPR, and it made extensive changes in the way the Federal Government procured goods and services. This legislation, in fact, repealed or modified more than 225 provisions in existing procurement laws.[Ref. 12:p.22]

The more significant changes included the following:

1. Created a micro-purchase threshold of \$2,500 and a simplified acquisition threshold of \$100,000. The intent is to allow Government contracting officers to acquire lower-cost goods and services without

having to comply with burdensome and inefficient statutory and regulatory requirements.

2. Gave greater emphasis to procuring commercial items (as opposed to items that are Government unique) and using commercial-type performance standards and specifications.
3. Created the Federal Acquisition Computer Network (FACNET) to facilitate the use of electronic commerce/electronic data interchange among Government agencies and private industry.
4. Encouraged the use of the IMPAC Government purchase card.
5. Reduced the requirement for Government-mandated terms and conditions in Federal contracts.
6. Encouraged the use of "best value" contract awards, in which Government contracting officers and source selection teams can use evaluation criteria (e.g., past performance) other than lowest price to get the best product or service for the Government.
7. Increased the Truth in Negotiations Act (TINA) requirements threshold to \$500,000 (i.e., contractors do not have to provide "certified cost or pricing data" to the Government at or below this dollar figure). [Ref. 15:pp.21-22]

The Federal Acquisition Reform Act of 1996 (FARA) built upon FASA by expanding the use of Simplified Acquisition Procedures for commercial items that cost \$5 million or less. The purpose of this expansion was to encourage greater use of commercial items and increase streamlining of the procurement process.[ibid.:p.22]

The overall objectives of FASA and FARA were to "empower" people (Government employees) to act quickly with reduced regulations, reduce administrative costs, improve opportunities for small and disadvantaged businesses and promote efficiency and economy in contracting.

### **3. Regulatory and Policy Changes**

In response to the statutory changes of FASA, then Secretary of Defense William Perry directed DoD in 1994 to use performance specifications in all acquisitions; procuring activities could use existing military specifications and standards only if it was absolutely necessary and only with prior approval. This change was a dramatic departure from long-standing DoD policies, and its purpose was to reduce the barriers that DoD faced in accessing the commercial marketplace. The objectives of this reform were to save money, remove impediments to



getting state-of-the-art technology for new weapons programs, and enable firms that had historically conducted most of their business with DoD to diversify into other markets (i.e., "dual use technology"). As of 1997 this policy change had resulted in over 8,000 changes, predominantly cancellations of military specifications and standards.[Ref. 15:p.9]

In 1995, Secretary of Defense Perry and Under Secretary of Defense (Acquisition & Technology) Paul Kaminski introduced and directed the use of two interrelated concepts: the Single Process Initiative (SPI) and Integrated Product Teams (IPTs). These concepts were directly in line with the NPR's goal of using the "team approach" in its quest to improve Government operations.

The SPI concept is based on the sound management objective of eliminating costly multiple processes in manufacturing facilities. In the case of DoD procurement, the intent was to eliminate the redundant and costly production and management processes that were so prevalent among defense contractors who also had commercial product lines. SPI built upon the Government specifications and standards reform of 1994, with the goal of allowing the contractors to rely on "world class" commercial processes

rather than Government mandated design and production specifications. [ibid.:p.11]

IPTs are a "multi-disciplinary" approach to implementing the SPI concept. These teams are comprised of representatives from different functional backgrounds including, in some cases, defense contractor personnel. This approach is meant to improve trust and cooperation among all the "stakeholders" of the acquisition process (a dramatic change in mindset for DoD), enhance the planning and structuring process, identify and resolve issues in a timely manner and reduce "cycle time" in procuring weapons systems. [Ref. 15:p.10]

These policy changes and reforms are but a few of the procedural changes that have occurred within DoD, but they do represent the intent of the overall reform effort under the NPR. Secretary of Defense William Perry stated that

DoD must [move] from its rule-based system of laws and regulations to a system in which, based on guiding principles, *professionals in the acquisition workforce exercise their judgment in making sound business decisions on behalf of the U.S. Government.* (italics added) [Ref. 26:p.9; Ref. 15:p.21]

Few people would disagree with this assessment, though it is predicated on the motivations, training and capability of the people who work in Government procurement. This critical factor in the acquisition reform effort is one that

has also received attention from Congress and senior DoD officials.

#### **4. The Acquisition Workforce**

In 1986, the Packard Commission described the DoD acquisition workforce as "undertrained, underpaid, and inexperienced". It emphasized the need to improve the professional status and training of the workforce in order to make acquisition reform efforts succeed.[Ref. 5: p.255; Ref. 15:p.29] For clarification, the term "acquisition workforce" includes not only designated civilian employees and appointees, but also mid- and senior-grade military officers who are directly involved in the acquisition process.

Congress listened to the steady barrage of criticism over this issue and passed the Defense Acquisition Workforce Improvement Act (DAWIA) in 1991, a piece of legislation that codified training, education and experience requirements and enhanced the professional status of the acquisition workforce. Though DAWIA preceded the NPR, this concept of workforce improvement quickly fell under the rubric of the 1990s acquisition reform movement. One result of DAWIA was the establishment of the Defense Acquisition University (DAU), an organization that manages the formal education

program (traditional classroom and distance learning) created by the Act.[Ref. 8:p.5]

Despite the incorporation of DAWIA goals into the NPR movement, the goals of the NPR actually created a conflict between these two programs. The core concept of the NPR, creating "a government that works better and costs less", has an internal tension that has undermined the goals of DAWIA. Donald Kettl noted that the political pressure to realize immediate cost savings shifted the NPR's focus more towards personnel reductions and away from long term process and efficiency improvements.[Ref. 16:p.3] DoD has reduced the workforce in acquisition organizations by more than 42% (250,000 people) since 1989, and 60% of that total reduction has occurred since 1993. [Ref. 8:p.5; Ref. 16:p.18] Government employees, including those in the acquisition community, have rightfully been skeptical of the official encouragement for "reinventing" Government and of the NPR's goal to "empower" Federal employees. What incentives do these people have to improve customer service, streamline processes and invest their time in professional development when their jobs may be eliminated?

To its credit, Congress did attempt to address this issue when it passed FASA in 1994. Title V of the act included provisions to foster the development of measurable

cost, schedule and performance goals, and, more importantly, to create incentives among the acquisition workforce to meet or exceed these goals. The legislation mandated establishment of these goals and incentive structures by October 1995. [Ref. 33:p.1] In 1997 GAO conducted a study to assess the status of title V implementation within DoD and applicable civilian agencies.

GAO found in its survey that DoD had, in fact, met the deadline for establishing the cost, schedule and performance goals. GAO also found, however, that DoD had not implemented the personnel performance incentive programs, nor had it submitted recommended legislative changes that would facilitate this implementation process. [ibid.:p.3] DoD gave the following reasons for not complying with the incentive program implementation:

1. Statutory prohibitions on paying monetary incentives to military personnel (10 U.S.C. 1124).
2. The inability to retain program savings for reinvestment purposes.
3. The lack of authority to "spot promote" civilians for accomplishing specific objectives.
4. Program managers' lack of control over cost, schedule and performance goals. [Ref. 33:p.4]

DoD officials also stated that attaining cost and schedule goals is heavily influenced by the program, budget and appropriations process, and that achieving performance goals is driven by the military service requirements and the technological approach of the defense industry.[ibid.:p.8]

These explanatory comments appear valid, yet they raise the question of why senior DoD officials have not submitted legislative proposals to eliminate or at least mitigate these impediments. These officials did not provide an explanation for this omission; instead, they stated that they were in the process of designing demonstration projects to provide the basis for new personnel systems.[Ref. 33:p.8] Why conduct demonstration projects when the lack of systemic incentives is so obvious that even Congress recognizes the need for and mandates a comprehensive incentive program?

The answer may be in a report sponsored by the Defense Systems Management College titled *A Model for Leading Change: Making Acquisition Reform Work*. The authors of this 1998 report found that the DoD workforce questioned the commitment to the reform effort for the following reasons:

1. Middle management is seen as an impediment to the effective dissemination of acquisition reform information and guidance.

2. Functional organization structures remain unchanged or have increased in depth.
3. No real incentives are in place to reward risk taking.
4. The processes for measuring and evaluating changes in acquisition process are meaningless to the workforce. [Ref. 1:p.5]

The report went on to state that the Government workforce has seen numerous reform efforts started, "only to watch them die on the vine as the administration or the leadership within the administration changes". [ibid.] These obstacles to reform implementation are virtually identical to those identified by Secretary of Defense William Perry in his 1994 report *Mandate for Change* [Ref. 26:pp.6-7] and it unfortunately appears that little has changed. Chapter III focused on this very issue, and the impact of this very powerful disincentive in implementing reform initiatives within the DoD workforce and among DoD officials cannot be overstated.

#### **D. CONCLUSION**

The changes wrought on the DoD acquisition process as a result of the NPR have, in fact, significantly changed the way the Government procures goods and services. Elimination

of mandatory use of Government specifications and standards, fostering cooperative (versus adversarial) relationships with defense contractors, legitimizing and enhancing the professional status of the DoD acquisition workforce and encouraging the use of innovative practices run counter to the rule-bound processes that have exemplified Government acquisition practices in the past.

Despite these improvements, the NPR has failed to deal with the truly critical element of any type of Government reform: The existing incentive structures in the Federal bureaucracy. As was noted in Chapter II, bureaucrats are budget maximizers who use rationality and survival to reach that end. There is no profit-maximizing goal that generates the incentives to reduce costs and use more efficient and innovative practices. On the contrary, the disincentives that the acquisition workforce face in light of massive personnel reductions over the last ten years are considerable. As discussed earlier, these people quite rationally see no reason to sustain these acquisition reform initiatives when their very employment depends on systemic inefficiency and procedural compliance. It also appears that DoD officials have done little to ameliorate these disincentives, despite legislative mandates to create goal-oriented incentives.



The bottom line for the NPR is, quite simply, to save money. The Clinton administration claims savings of \$117 billion over five years, half of which comes from personnel reductions. Donald Kettl pointed out, though, that most of these savings are impossible to verify.[Ref. 16:pp.17-18]. This overriding priority, driven by political expediency, has undermined the long-term legitimacy and sustainability of the NPR and acquisition reform.[ibid.:p.6] Lauren Holland noted anecdotally that major weapons systems programs are still incurring the same cost overruns that have plagued DoD for the past 35 years.[Ref. 13:p.235] She, Donald Kettl, J. Ronald Fox and any economist know that unless the Government changes the basic incentive structures within the bureaucracy, the NPR will go down in history as another half-hearted attempt to reform a system that, by its very nature, is inefficient and effectively resistant to change.

The following chapter gives a history of the U.S. Civil Service and an overview of recent personnel reform efforts. This next chapter uses New Zealand public sector reforms as a benchmark and as a basis for analysis of the U.S. reform efforts.

## **V. GOVERNMENT PERSONNEL REFORM EFFORTS AND ACQUISITION REFORM**

### **A. INTRODUCTION**

This chapter gives a brief history of the U.S. Civil Service and an overview of recent personnel reform efforts. It also expands upon the importance of the underlying incentives in the Federal workforce (including the DoD acquisition workforce) against the backdrop of public sector reform efforts. This chapter uses New Zealand public sector reforms as a benchmark and as a basis for analysis of the U.S. reform efforts.

### **B. HISTORY OF THE U.S. CIVIL SERVICE**

Today's civil service systems originated in the civil service reforms, "good government", and "scientific management" movements of the Progressive Era (the late 19<sup>th</sup> and early 20<sup>th</sup> century period). These movements were the result of the general backlash against the abuses of the "spoils system" and political patronage that had defined the Government employment system since the beginning of the Republic.[Ref. 4:p.13] The civil service reformers believed

that honesty and efficiency in Government were two complementary goals readily achievable with these reforms.

Woodrow Wilson and other reform advocates stressed that efficiency in the civil service required that Government personnel be experts in their respective areas of employment. This expertise, along with efficient design of the bureaucratic institutions, would result in a "corps of civil servants prepared by a special schooling and drilled, after appointment, into a perfected organization, with appropriate hierarchy and characteristic discipline".[ibid.] This need for civil service expertise - matched by high moral caliber - required, in turn, a stricter employment process.

In 1883 President Chester A. Arthur signed into law the Pendleton Act, which provided for the appointment of career Government officials on the basis of merit. Civil servants now had the promise of steady employment and the right not to be fired except for cause. Formal job classifications came after the Pendleton Act in the belief that personnel experts would "scientifically" assign responsibilities to units, match skills to assigned responsibilities, and systematically link workers' salaries with their skills. [Ref. 4:p.14] The prevailing logic of this legislation and the subsequent classification procedures was to shield

career civil servants from the vagaries and political opportunism of the "spoils system" that could, in turn, undermine their ability to perform the functions and responsibilities of the Federal Government. In attempting to minimize these external factors, however, the reformers did not appear to take into account the impact these job security guarantees would have on the incentive structures within the Federal workforce.

The next step in civil service reform was the Classification Act of 1923. This legislation provided for the establishment of paygrades within each Government service category and imposed the standard of "equal pay for equal work". The act also codified the principle of "rank in job", as opposed to the "rank in person" concept used in Europe. This standardization of the job classification system throughout the Federal Government was a predictable expansion of the earlier reform efforts that emphasized - and were predicated on - impartial job assignments, skill evaluations and commensurate pay determinations. One has to wonder how this "one-size-fits-all" approach to personnel management in an environment of limited information could effectively factor in the diverse motivations and talents of the individual workers.

In 1949 Congress extended job classification to all but a few specifically exempted civilian Federal employees, and centralized classification authority in the Civil Service Commission. Congress also created a unified general pay schedule of eighteen grades, each with its internal promotion steps carrying increased pay with increased seniority in the grade. This consolidation of the Federal personnel system reinforced the importance of seniority in promotion and pay decisions and concurrently reduced management authority over Federal workers.

The last statutory change in the Federal career service was the 1978 Civil Service Reform Act. This legislation changed the title of the Civil Service Commission to the Office of Personnel Management (OPM), ostensibly putting it on equal footing with the Office of Management and Budget (OMB). It provided greater flexibility to appoint, promote and fire personnel, though this last feature has apparently turned out to be more wishful thinking than reality and will be a point of discussion in a later section. This act also created the senior executive service (SES), a recommendation from the second Hoover Commission in the 1950s. The purpose of the SES was (and is) to provide an elite group of senior bureaucrats who could fill the critical jobs that fall in between the presidential appointees and the rest of the

civil service in the administrative, professional and technical jobs.[Ref. 4:pp.14-15]

John DiIulio and Gerald Harvey have made the case that the legislative reforms begun by 19<sup>th</sup> century Progressives have

caused the emergence of overly rigid, bureaucratized personnel systems that can frustrate productive workers, protect unproductive ones and...seem incapable of distinguishing one from the other and rewarding effective performers....[ibid.:p.15]

A number of studies and civil service reform commissions have found that the American public's perception of Government employment is that of "guaranteed job security, income and retirement" with an overwhelmingly negative attitude toward career and advancement opportunities in the Federal Government. [Ref. 4:p.15; Ref. 19:pp.123-124] The Volcker Commission also found that the quality of Government hires is significantly lower than that of equivalent private sector hires, as measured by aptitude tests and gradepoint averages.[Ref. 19:p.123]

The importance of these data is two-fold:

1. The perception and reality of today's Federal civil service is the diametrical opposite of the "scientifically managed" corps of experts envisioned by the Progressive Era reformers, a result of the

"law of unintended consequences" and the failure to factor in the importance of incentives.

2. As originally stated in Chapter II, the idealistic (and unrealistic) beliefs of the early reformers confirm Dr. Niskanen's criticism of their characterizing bureaucrats as selfless individuals who subordinate their own self-interest to the best interests of the Government and populace.

In reacting to the real or perceived abuses of the spoils system, the reformers created a bureaucratic organization that has squelched the possibility for instilling the systemic initiatives necessary for sustaining initiative, innovation and "expertise" in the civil service (i.e., the unintended consequences). This lack of positive incentives in the civil service has had an additional consequence of reducing the supply of the "best and the brightest" potential employees, given the better opportunities in the private sector. The typical civil servant, in turn, responds to the initiatives that remain within the bureaucracy to enhance his or her own self-interest, using rational and survival-driven techniques.

It is important to emphasize that the very nature of Government (no profit motive or fear of bankruptcy and monopsonistic/monopolistic characteristics) makes it very

difficult - if not impossible - to create the incentives that readily exist in competitive, profit-maximizing firms. Civil service "reforms", however, have only made this problem that much harder to overcome.

### **C. RECENT PUBLIC SECTOR REFORM EFFORTS**

Federal recruitment and retention problems, as well as the Government's desire for its agencies to copy commercial business and management practices, resulted in a string of public sector reform efforts beginning in the late 1980s with the Volcker Commission and continuing on with the NPR. These efforts are not the first attempts at Federal employment reform; the second Hoover Commission addressed many of the same issues in the Volcker Commission report. The author will focus on recent reform efforts because of their relevance to current acquisition reform efforts.

#### **1. The Volcker Commission**

In 1989 the Volcker Commission, formally known as the National Commission on the Public Service, published the report *Leadership for America: Rebuilding the Public Service*, which gave a laundry list of recommendations to improve the Federal Government workforce. The Commission was composed of 36 members from the private sector and



academia, and established itself as a privately financed entity with no direct ties to the Federal Government. In a striking parallel to the NPR and its antecedents, the Volcker Commission is the most recent in a long history of "blue ribbon" studies of the Federal civil service dating back to the early 1900s.[Ref. 4:p.xiii] Its overall purpose was to address the need to make the Federal Government's personnel system more responsive, accountable, and cost-effective.[ibid.:p.xi]

The Commission's report is actually composed of five separate task force reports covering the following topics: Public Perception; Recruitment and Retention; Education and Training; Pay and Compensation; and Relations between Political Appointees and Career Executives. The reports focused on a number of overarching issues that formed the basis for the Commission's observations and recommendations and created overlap in some or all of the topical areas:

1. Federal Government pay and other compensation.
2. Public perception and attitudes toward the civil service (and the Federal Government in general).
3. Recruitment and retention problems.
4. Political appointments and the impact on the civil service.[Ref. 19]

The most demonstrable and verifiable problem identified by the Volcker Commission was the pay gap between Federal workers and their counterparts in the private sector. The Commission found that as of 1987 the Government paid its employees 20 to 50 percent less than their peers in the private sector.[Ref. 19:p.206-207] This gap was most egregious at the senior executive/political appointee level, which had statutory caps on the level of compensation and "compressed" salaries at the highest paygrades.[ibid.:p.200] The Commission also noted that the Government did not compensate workers who lived and worked in high cost areas, exacerbating the pay differentials.[Ref. 19:p.201] This lag in pay resulted in a preponderance of entry level employees from the lowest quartile of the labor market, especially among scientific and technical fields. The Government was also having a difficult time recruiting qualified personnel for senior appointed officials and in retaining senior civil service executives and managers.[ibid.]

In response to the Commission's recommendations, Congress and the President did take action in authorizing the use of "locality" pay for General Schedule (GS) employees in high cost areas, as well as boosting the salaries of all employee paygrades (including raising the executive ceiling cap) to offset the worst of the pay

disparities.[Ref. 4:p.xi] Ironically, the Government used the locality pay concepts from the Federal Wage Grade (i.e., "blue collar") pay determinations that had been in use for decades. These modest efforts lost a significant amount of impact, however, when the Clinton administration imposed civil service salary freezes in 1993 as a deficit-cutting measure.[Ref. 17:p.12; Ref. 4:p.xii]

The Commission also focused on the profoundly poor image of the civil service and of the Government in general. This "bashing the bureaucrat" mentality is one of the distinguishing characteristics of American society, but the Commission noted that distrust of the Government had reached an all-time high.[Ref. 19:p.2] The Commission members emphasized the negative impact these attitudes have had in attracting and retaining qualified and dedicated Government employees, especially among college graduates.[ibid.:p.123] This climate has also been a significant factor in the loss of senior career managers through resignation and early retirement.[Ref. 19:p.75]

Another issue that the Commission focused on was the proliferation of political appointees and its impact on the rest of the civil service, specifically the Senior Executive Service (SES). The Commission contended that the high turnover (two years average tenure) among these growing

numbers of appointees diffused accountability and limited career potential of the career civil service.[Ref. 19:p.163] Paul Light analyzed and corroborated the widespread existence of this accountability problem in his 1995 book *Thickening Government*. [Ref. 20] These problems were compounded by, and a direct result of, the low pay issue discussed earlier. The Commission recommended that the Executive branch improve the screening process of the potential appointees while simultaneously working with Congress to reduce the number of appointed positions in the Government. [Ref. 19:p.164] Interestingly, this recommendation runs counter to the second Hoover Commission's recommendation to *expand* the number of political appointees by a factor of five (to 5,000); the intent was to "shield" career civil servants from political interference and controversy. [Ref. 21:p.35]

In addition to their recommendations regarding pay and political appointees, the Commission also recommended a wide range of initiatives to promote Federal employment, including expanded recruiting efforts on college campuses, greater Presidential and Congressional recognition of Government agencies and employees, and improved training and career development initiatives. Finally, the Commission recommended a limited decentralization of personnel

management authority to counteract the limits imposed by 100 years of civil service statutory reform.[Ref. 19]

One positive outcome of the Volcker Commission was its influence on the passage of the Defense Acquisition Workforce Improvement Act (DAWIA) in 1991, as discussed in Chapter IV. This act addressed DoD's need to improve the professional status and training of the acquisition workforce, a shortcoming strongly emphasized in the Commission report.

In reviewing and analyzing these recommendations and their underlying rationale, one can make the case that the members of the Commission appeared to limit their focus to the extrinsic incentive problems, such as poor pay, while minimizing the importance of internal incentive structures within the rigid, highly bureaucratic civil service system. For instance, the task force on Public Perception stated that the President, Congress, agency heads and senior management should make a concerted effort to create a more favorable work environment, strive for excellence in Government programs, emphasize customer service, and recognize the agencies and its employees.[Ref. 19:pp.8-9] In light of the senior executive/management pay, morale and retention problems mentioned throughout the report, what are the incentives to initiate and sustain such sweeping changes

in the bureaucracy? The tangible rewards to the agency officials for embarking on such an ambitious program are virtually non-existent.

In the introduction to *Deregulating the Public Service*, Paul Volcker lamented the lack of effort and even the resistance in implementing the Commission's recommendations.[Ref. 4:p.xii] Though this apparent inertia is regrettable, it is a rational response on the part of Government executives and managers, given their lack of incentives to embrace these reform measures. The Commission did, in fact, recommend decentralizing decision-making authority in personnel management, but only within the framework of the existing civil service system and the limitations it imposes on management discretion. In other words, substantive change would be minimal and inconsequential.

## **2. The Government Performance and Results Act (GPRA)**

President Clinton signed the Government Performance and Results Act (GPRA) into law in 1993. Its purpose is to establish a framework for the Federal Government to develop sophisticated performance-based management systems, and it is built upon the "new public management" reform efforts in Australia, Canada, New Zealand, and the UK.[Ref. 16:p.46]

Though this law coincided with the launch of the NPR, it is not actually part of these reform initiatives. Instead, it comes under OMB's purview, because the Federal agencies are required to submit strategic plans to the Director of OMB for review and approval.[Ref. 11:p.264]. Its goal is to improve "the confidence of the American people in the capability of the Federal Government, by systematically holding Federal agencies accountable for achieving program results".[Ref. 17:p.42; Ref. 11:p.263]

Under the act, each Federal agency (with a few exceptions like the GAO and CIA) must fulfill the following requirements within the ten year phase-in period:

1. Prepare a five year strategic plan, updated every three years.
2. Prepare a comprehensive mission statement that links the agency's current operations with its long-term goals.
3. Identify the goals and objectives, along with the resources, systems and processes required to achieve the goals.
4. Describe the most important external factors that could affect the agency's success in achieving the goals.

5. Provide annual program evaluations to help agency officials assess their success, explain why goals might not have been met, and revise the goals as necessary.[Ref. 17:p.42]

The GPRA is an attempt to shift agency officials' perspectives from that of managing inputs (i.e., funding and personnel levels) to achieving output and outcome goals as delineated in their respective strategic plans. The concept is to allow the "stakeholders" (Congress, taxpayers, the President) the means to evaluate the agencies' abilities to meet their public policy objectives with the resources they have available to carry out these objectives.[Ref. 11:p.271] Donald Kettl noted, however, that it is far easier to talk about performance management than to do it. Defining and measuring outcome goals is extremely difficult because of the unique nature of Government programs and services, and because of the different and often conflicting goals and incentives of the interested parties.[Ref. 17:p.44] An issue of equal importance in this attempt to ensure accountability within the bureaucracy is the presence or absence of incentives to actually fulfill the requirements of this law.

An organization with the interesting title of "The Chief Financial Officer's Council GPRA Subcommittee"



conducted a 1996 review of Federal agencies' efforts to comply with the GPRA mandates. They found that agencies' efforts were focused on performance planning (the measurement of outputs and outcomes) that was not linked with any strategic planning. In other words, the agencies were taking the path of least resistance by generating quantifiable measures of "success" without using the framework of the strategic plans that is supposed to guide these subordinate performance-planning processes in the first place. The subcommittee stated that "part of the problem...stemmed from the lack of incentives to do good program evaluations and the strong incentives to expand programs and missions".[Ref. 11:p.271]

This evaluation does not imply that Government agencies are incapable of performing these strategic/performance-planning functions. GPRA authorized pilot programs within the Federal Government, including seven DoD agencies, that provided Government executives with valuable experience.[ibid.:p.265] These early participants reportedly were very enthusiastic about the process and were committed to making it an integral part of the agencies' decision-making process.[Ref. 17:p.43]

Transferring this enthusiasm and level of commitment to the rest of the Department of Defense, however, has been

more difficult. A GAO report evaluating DoD's Fiscal Year 1999 Performance Plan noted some significant shortcomings in its preparation and presentation:

1. The plan did not explain some key elements, including clear identification of DoD's performance goals and the means to measure these goals.
2. The plan did not include baseline or benchmark data as a means of evaluating progress towards the performance goals that were identified.
3. The plan primarily used output measurements (e.g., force readiness and capabilities) rather than outcome measurements (the effectiveness of U.S. forces in carrying out foreign policy objectives).
4. DoD financial systems and the underlying logistical, budgetary and operating systems that support them lack data integrity and verifiability. GAO argued that DoD included few cost-related efficiency measures because of these inadequate systems; DoD senior officials, in turn, did not try to refute this contention.
5. DoD argued that its use of the existing Planning, Programming and Budgeting System (PPBS) met the requirements of GPRA, even though this system is an integral part of the DoD financial management system

that GAO has evaluated as a "high-risk" program susceptible to fraud and mismanagement.[Ref. 34]

GAO did acknowledge the challenge that DoD faced in creating a comprehensive strategic plan that included quantifiable and verifiable performance measurements and outcome goals. Few observers would dispute this statement. Given the reported success of the seven pilot programs, however, why has DoD seemingly not been able to build on these initial efforts and avoid GAO's negative evaluation?

The answer rests on an understanding of the incentives and constraints that DoD officials face. These officials' primary personal goal is to keep their jobs and a secondary but closely related goal is to maximize their budgets. The constraint they face is an atmosphere of ambiguous and conflicting pressures from various interested parties. Establishing concrete, measurable goals for public policy objectives ("the outcomes") in an unstable decision-making environment comprised of congressional members, the President, political appointees and countless observers can be almost impossible. Information is an economic good, and even the most experienced and knowledgeable agency official (or group of officials) cannot collect and assimilate all the information necessary to determine optimal resource allocation throughout DoD, nor can this official (or

officials) possibly incorporate all the conflicting interests in this comprehensive planning process.

Survival is the other factor that directs the actions and attitudes of the agency officials. Donald Kettl emphasized that Government managers have little incentive to allow anyone to measure what they actually do. [Ref. 17:p.44] This statement is quite logical given the previously-described uncertainties that the managers and senior officials face in trying to define and measure any relevant policy outcomes. Despite these uncertainties and the economic costs associated with information gathering, one can also argue that the Government officials and managers have relatively more pertinent information than do their sponsors (i.e., Congress). To minimize their risk of budget reductions, program elimination and/or increased oversight, members of the bureaucracy have a very strong incentive to downplay, distort or simply not address potentially negative issues. They will use the one significant advantage they do hold - superior organizational knowledge - to maximize their own interests, since they have little or no incentive to do otherwise.

DoD could conceivably generate the most comprehensive, verifiable and outcome-oriented strategic plan that would answer GAO's criticisms and recommendations, if it devoted

substantially greater levels of effort and scarce resources to the planning process. In reality, though, the probability of this increased effort is low because of the resource constraints and, more importantly, because it is not worth it to DoD officials and managers. As Paul Light,[Ref. 20:p.181], Donald Kettl,[Ref. 16:p.55] and J. Ronald Fox have all pointed out, DoD knows that Congress will do little, if anything, to seriously penalize the organization or its employees if they don't fulfill the legislative mandates. Viewed from this different perspective, it comes as no surprise that DoD officials responded to GAO's criticisms by stating that they were "making a good faith effort" to comply with GPRA.[Ref. 34:p.2] They are rationally responding to the incentives that exist in a subjective and very fluid environment.

### **3. Civil Service Reform Efforts under the NPR**

Civil Service reform was another major theme of the NPR, a necessary step to "empower" Government employees to innovate and perform everything "smarter, better, faster and cheaper".[Ref. 10:pp.69-70] The goal of this reform effort was to decentralize decision-making authority throughout the Federal bureaucracy while simultaneously eliminating the

layers and numbers of middle managers/supervisors. Reformers believed that doubling the management "span of control" (i.e., changing the manager-to-employee ratio from, say, 1:7 to 1:15) would improve organizational focus and customer responsiveness. [Ref. 10:p.71; Ref. 16:p.19] The implicit assumption underlying these beliefs was that this decentralization would, in essence, create incentives (or eliminate management-imposed disincentives) among the workforce to take risks, solve problems, improve customer service and enjoy more meaningful and challenging jobs.

One major obstacle in any reform of the civil service is opposition from the Government employee labor unions, primarily because they fear greater management authority over hiring, firing, assignment and promotion decisions. This change, in turn, would undermine union influence in the Federal workplace and potentially lead to the loss of union jobs. [Ref. 20:p.29] The NPR operated in a dynamic environment anyway because of the planned reductions in the civilian workforce, as discussed in Chapter IV. In order to minimize union opposition to NPR reforms as a whole, the Clinton administration created an alliance with the labor unions that would give them a significant voice in the direction and implementation of the *remaining* NPR reforms. [Ref. 10:p.87; Ref. 17:pp.13-14] Donald Kettl pointed out

that the administration's accommodation of organized labor effectively eliminated the opportunity to institute meaningful civil service reforms. Congressional opposition, fostered in part by union lobbying, confirmed the reforms' "dead on arrival" status.[Ref. 17:p.53]

Abandoning any substantive effort at civil service reform created a difficult situation for the NPR. It had targeted middle management and supervisors as the focal point of personnel reforms and workforce reductions. This contradictory message in and of itself had the predictable effect of alienating Government managers; the administration's abandonment of civil service reforms compounded this muddled message by explicitly siding with the labor unions at the expense of improved management decision-making authority in the workplace.[Ref. 16:p.14]

For a number of reasons not directly related to NPR reform efforts, the largest proportion of personnel cuts during the 1990s has actually fallen on the lower grade workers that were supposed to be the beneficiaries of the this decentralization effort. These reasons include the drawdown of the military and its resultant reduction in DoD civilian employment, the outsourcing of Government functions and services to private firms and state and local governments,[Ref. 17:p.20] and the failure to eliminate

layers in the Federal bureaucracy, especially among political appointees. [Ref. 20:pp.7,64,161; Ref. 16:p.21] The traditional pyramid organizational structure has, to a large degree, flipped on its "head", an outcome that the NPR reformers neither envisioned nor desired.

Two separate Government surveys provide a mixed picture of Federal employees' perception of the NPR reforms. A 1996 report of the Merit Systems Protection Board (MSPB) found that less than one-third of the civilian and military members of the DoD agencies (DLA and the military departments) believed that their respective agencies had made reform initiatives a top priority. Only 20 percent of all Federal workers stated that the NPR had brought positive changes to the Government; in the Federal agencies where NPR was perceived to be a high management priority, however, 59% of these employees believed that NPR reforms had improved productivity.[Ref. 35:pp.10-15] A 1999 survey of the acquisition workforce found that 74% of the respondents stated that agency managers were supportive of reform initiatives; this factor, along with management guidance and program funding stability, was most important in influencing the impact of reforms. [Ref. 32:p.iii]

The major point that the reader can take away from these surveys is that management support is a critical



factor in employee attitudes toward reform efforts. The question that these surveys do not address, however, is the long-term sustainability of the reform efforts, and what incentives exist (if any) for these managers to maintain this high level of support.

The reality of personnel reform efforts during the NPR is one of contradictory and sometimes self-defeating goals, compromised by short-term political expediencies and external factors beyond the control of the NPR. The end result is that the NPR's focus on the Federal managers/supervisors as the cause and cure for a system that does not reward initiative and risk taking is another symptomatic treatment that ignores the critical importance of incentives. Donald Kettl, Paul Light and James Q. Wilson have all stated repeatedly that these reform efforts must have the right people - with the proper incentives - to lead these efforts. Instead of correcting the underlying problems that create the disincentives in the first place (e.g., rigid, rule-driven civil service procedures), the reform efforts have instead been based on questionable logic that presumes the existence of incentive structures that do not currently exist in the Federal Government.

#### D. NEW ZEALAND PUBLIC SECTOR REFORMS

In 1984 New Zealand embarked on a public sector reform program that has been unanimously characterized as one of the most comprehensive and ambitious government overhauls in recent history. Allen Schick, in his 1996 report *The Spirit of Reform: Managing the New Zealand State Sector in a Time of Change* states that this reform has been an

extraordinary transformation of the State sector from centralised control of money, personnel and other resources to devolved arrangements that give managers control of inputs, provide them with incentives to be productive, and hold them accountable for results. ...New Zealand has been more venturesome than any other country in discarding old practices and devising new ones.[Ref. 28:p.2]

New Zealand's reforms resemble those introduced in Australia, the UK and Sweden, though the scope is much more extensive. Some of the major innovations include the following:

1. Financial statements, the budget and appropriations are on an accrual basis. Public entities use commercial accounting standards.
2. Departments prepare periodic reports, including semiannual reports on the chief executive's performance agreement and an annual report on

financial results and outputs. The Government also issues an annual combined financial statement.

3. Appropriations for operating expenses are made by output classes. The output classification is the basis for expenditure control and accountability evaluation.
4. Chief executives are department heads who receive their appointments under performance output contracts for fixed time periods. Public employees work under individual or collective employment contracts.
5. Managers have much greater discretion and authority than their counterparts in other countries. Within budget limits and law managers are free to select the mix of inputs for use in producing agreed outputs. They have flexibility in hiring and paying staff, obtaining office accommodations, purchasing supplies and services and spending on other inputs.
6. Contract-like arrangements maintain accountability for resources and results. Performance agreements between Ministers and chief executives set forth standards and expectations for department heads. Purchase agreements between Ministers and departments specify the annual outputs.

7. Departments maintain their own bank accounts, earn (and retain) interest on these accounts, and are responsible for managing cash balances.[Ref. 28:pp.2-3; Ref. 18:pp.66-75]

Note how incentive structures permeate these reform efforts. The department heads get their jobs based on performance contracts, and employment periods last only three to five years. Allen Schick emphasized that these executives are selected on a true merit basis, rather than on seniority in Government service.[Ref. 28:p.1] It would be naïve to think that this selection process is totally free of political interference, but the use of enforceable and measurable contractual requirements and the elimination of guaranteed employment can mitigate political interference in the appointment process.

In order to achieve their measures of accountability, the department heads and their subordinate managers have broad authority over resource use and allocation. They are completely responsible for managing their labor force, accounting for their financial resources and expenditures, and determining the most economically efficient way of achieving the expected outputs. More importantly, they have the *incentive* to maximize this efficiency because (1) they control the factors of production and service that directly

affect their ability to meet their contractual requirements; and (2) their performance contracts include bonuses and penalties directly tied to meeting output objectives.[Ref. 22:p.2] Improved management controls and commercial practices, including the use of capital asset depreciation, enhance this ability to efficiently use these resources.

These incentives flow down to the New Zealand Government employees. The 1988 State Sector Act eliminated lifetime job guarantees for all Government employees and decentralized staffing and wage determination authority to the department heads.[ibid.:p.1] As a result, these employees can no longer use rigid civil service and/or union work rules to counteract management discretion, and they can lose their job for poor performance. Conversely, these same employees now have the incentive to show initiative and use innovative practices to boost their own employment opportunities. And with the elimination of guaranteed employment, they also have the incentive to seek better employment in the private sector if they are dissatisfied with their current position.

The impetus for these radical reform efforts was the dismal state of the New Zealand economy. New Zealand had followed the same interventionist policies of many of the other OECD (Organization for Economic Cooperation and

Development) countries in the post-World War II period: Government ownership of major industries, protectionist trade policies, high marginal tax rates and extensive economic regulations. The predictable result of these policies was a moribund economy that had one of the lowest GDP growth rates among developed nations (i.e., Europe and North America) in the 1970s and early 1980s.[Ref. 28:p.12]

In 1984 a new center-left Government won the national elections with a mandate to institute drastic change and turn the economy around. Rather than continuing the socialist policies of the past, the new Government immediately began the process of liberating the economy by dismantling wage and price controls, deregulating major sectors of the economy, privatizing major industries, ending most subsidies and reforming the tax system. Within a few years New Zealand went from a virtual autarky to one of the most open economies in the world.[ibid.:pp.14-15]

After successfully deregulating the economy, Government officials turned their attention to reforming the public sector. The author firmly believes that New Zealand's equally radical reformation of its public sector stems from the confluence of like-minded senior political leaders who took control of the Government in 1984. Their decision to embark on this reform effort was not driven by self-

interest, *per se*, but rather by the realization that the country could not continue the ineffective policies of the past. One could argue that the political leadership was attempting to maximize its utility ("well-being") through a risk and reward trade-off calculus that would otherwise result in the continued decline of the country. This argument is one that applies - in a more limited context - to the current acquisition reform efforts in the United States, and will be addressed in later sections.

Despite the ambiguities of the political leadership's motivations for reform, the theoretical framework for these reforms echoes Dr. Niskanen's theory of the utility-maximizing bureaucrat presented in Chapter II. According to the New Zealand reformers, led by Finance Minister Roger Douglas, the "institutional economics" theory traced its roots to the 1937 article "The Nature of the Firm" written by the economist Ronald Coase and published in the journal *Economica*. [Ref. 16:pp.12-13] Not surprisingly, it is based on the valid assumption that people act in their own self-interest to maximize their utility ("well-being"). [Ref. 28:p.17]

The "new" institutional economics takes self-interest to its logical conclusion: all economic relations are implied or explicit contracts between parties that have

different interests but cooperate for their own purposes. The problem arises when one or both of the parties acts "opportunistically" in an agency theory context, in which the agents take actions that are in their own self-interest but are not in the best interest of the principals (i.e., civil servants perform actions or make decisions that enhance their own well-being but undermine the efficient operation of the Government). [Ref. 28:p.17-18]

This opportunism occurs because information is costly and valuable. Referring again to chapter II, Niskanen's description of the bureaucratic environment parallels this concept of information as an economic good: the sponsors (the principal) do not have the incentive to attain all the information necessary to fully understand the actions and motivations of the bureaucrats (the agents); the bureaucrats, on the other hand, have a much greater incentive to obtain more information regarding their position and organization. The result is an asymmetry of information that enhances agent opportunism and the ability to "capture" the principal. Capture is the ability of agents to selectively provide information that compels the principal to act in the interest of the agents. [ibid.]

The New Zealand Treasury Department, in its 1987 brief *Government Management*, summed up the difficulty of reforming



the public sector. In this brief the department argued that the Government

is prone to opportunism because it lacks the checks on behavior that come from the need to satisfy customers [i.e. it does not have to compete]. Those who work for the State have a tendency to pursue their own goals, to shirk and to featherbed, and to pay insufficient care in the use of [Government] resources. ...The asymmetry of information creates the potential for opportunism or subgoal pursuit by the bureaucracy including...budget maximization and generally inefficient policies for society as a whole.[Quoted in Ref. 28:pp.18-19]

This statement is essentially a restatement of Niskanen's theory of bureaucracy. The importance of it cannot be overstated: the New Zealand Government was very realistic in its appraisal of the obstacles it faced in successfully reforming the public sector. The reformers knew that public exhortation and statutory mandates would not instill the incentives required to implement and sustain the reform efforts.

What have these reforms achieved? Quantitatively, there has been a significant change in the structure of Government and its role in the economy. The number of civil servants has declined from 87,000 to 40,000 over the last ten years[Ref. 18:p.61], and the Government has sold off \$16 billion (NZ) in state-owned businesses and assets.[ibid.:p.30] This privatization effort has resulted

in a reduction of the Government's share of GDP from 42% in 1992 to 35% in 1998. [Ref. 18:p.39] A Treasury survey of Government departments found an average 10 percent cost savings (in both per unit of output and aggregate figures) with constant or slight increases in demand for their applicable services or products. [Ref. 28:pp.4-5] Whether or not these figures accurately access true long-term economic efficiency gains, however, is hard to determine.

Qualitatively, Schick found an overwhelming consensus among more than 100 department heads, senior managers and informed observers that these reforms have "improved the efficiency and quality of public service by encouraging managerial initiative and rewarding success". [Ref. 28:p.4] Schick also found - albeit from non-scientific interviews - that the lower-level employees professed pride in their own efficiency and service improvements, and acknowledged the value of senior level recognition for these improvements. [ibid.:pp.5-6]

Schick implied in his discussion that the potential "cost savings" from these reforms are being "used up" by the departments through capital and training investments, development and installation of performance monitoring systems, recruitment of skilled managers, and service enhancements. From an economic perspective, however, the

department managers are rationally responding to the systemic incentives that encourage them to maximize the efficiency of their operations, and rightfully so. The managers are expected to take a long-term perspective for the benefit of the department, its customers and its employees, with these benefits tailored to Government performance requirements and goals spelled out in the employment contracts.

The New Zealand public sector reforms are by no means perfect. The absence of any real profit motive, the preponderance of monopolistic provision of Government services, arbitrary budget limits and political interference can create obstacles to fully implementing private sector-type incentive structures in Governmental operations. In addition, there is some criticism from Schick and other observers that the New Zealand reforms focus too much attention on the outputs (the actual goods and services provided) rather than the outcomes (meeting public objectives through these outputs), and that the cost of establishing and monitoring the performance requirements is excessive.[Ref. 28:p.7 & pp.60-61; Ref. 18:p.101] Given the more subjective nature of outcome measuring and the need to offset the lack of market forces in this process, however,

the use of output measurements may be the most effective long-term compliance mechanism.

Despite these real or perceived shortcomings, one only has to think of the alternative (reverting back to centralized control) to realize that the opportunity cost of New Zealand's public sector reform efforts is very low. This country has 15 years of experience and empirical data to show that comprehensive reform - which includes proper incentive structures - can, in fact, succeed.

#### **E. A BENCHMARK COMPARISON AND CONTRAST**

At the outset, it would appear that comparing and contrasting the reform efforts of New Zealand with those of the United States is like comparing the proverbial apples and oranges. New Zealand has a population of 3.8 million people, and defense spending is less than 1% of GDP for its limited-mission military services. What value does the reader gain by using New Zealand as a benchmark against one of the largest bureaucracies in the world?

The answer lies not so much in the absolute magnitude of the organizations in question but in the different ways these two countries have tackled their respective reform efforts. This statement does not diminish the complexity and difficulty of restructuring and reforming the multitude

of agencies and departments within the United States Government, including DoD. Nevertheless, Vice President Gore and the NPR staff have, in fact, used New Zealand's reform efforts as one of its models for "reinventing" the Federal Government. [Ref. 9:p.6; Ref. 16:p.13] Given the voluminous empirical data and lessons learned generated in the 15 year New Zealand experiment, it brings up the question of why the United States Government has not been more successful in implementing these proven initiatives despite years of trying.

One pertinent factor is the different political structures of these two countries. New Zealand's parliamentary system is arguably more conducive to comprehensive reform efforts because there is relatively little dissent (generally speaking) among the elected members of the ruling party or coalition. As the author stated in the last section, the New Zealand Government that came to power in 1984 had an overwhelming mandate to fix a sick economy. The senior political leadership was unanimous in its belief that only radical restructuring of the public sector would ensure the longevity, sustainability and success of the equally drastic economic reforms. The Government was able to fully implement these reforms, in part, because of the institutional control that the Prime

Minister, his cabinet and the other majority members of Parliament had over the rest of the Governmental agencies and organizations.

The United States has a very different form of Government. This country's unique Constitutional checks and balances between and among the three Government branches are, by Founding Father design, "inefficient" and encourage dissent.[Ref. 20:p.109; Ref. 29:pp.167-171] Consequently, the Executive branch and Congress are often locked in battles over conflicting policy agendas and "turf battles", as any contemporary observer (and a reader of history) can attest. This atmosphere makes it all the more difficult to build a strong consensus among all the interested parties to endorse and undertake major reforms such as the NPR and civil service reform. Given these ambiguities and mixed signals, the bureaucrat has no incentive to embrace radical reform initiatives that might disappear with next administration and could endanger his or her job in the interim.

The lack of substantive personnel management (i.e., civil service) reform is also an important difference between the two countries' public sector reform efforts. As mentioned earlier, New Zealand department heads and managers have direct control over their labor resources as part of

their performance contracts with the Crown; this "ownership interest", in turn, creates the incentive to maximize the efficient use of these and other resources. In the United States, however, Government executives and managers have substantially less discretion and control over personnel management issues. For example, a September 1995 Issue Paper of the Merit Systems Protection Board addressed the difficulties in firing poor performers, a process that the 1978 Civil Service Reform Act was supposed to make easier. In this report over 75% of the 5,700 Government managers interviewed stated that it was not worth the effort to even attempt to remove poor performers in the Federal Government. Why? Because the process is difficult, time-consuming, and prone to second-guessing through five different avenues of appeals available to Federal employees. [Ref. 36:pp.1-2] In this one example of constraints on the managers' authority, what incentive do they have to maximize efficiency and reduce costs when they don't have any real control over the resources in their organization?

Taking the "ownership interest" concept one step further, one can argue that the New Zealand performance contracts establish a "property right" - and the resultant positive effects on economic efficiency - for the department heads and managers, since these contractual agreements

confer broad authority over the means of production in reaching the output goals of the agreement. These senior executives bear the full costs and benefits of their production decisions (including the potential loss of their jobs at the end of the performance period) to the maximum extent practicable in a pseudo-commercial market setting.

In the United States there is no equivalent property right or ownership interest. The GPRA is an attempt to establish accountability and performance goals among senior agency executives, but these executives have little, if any, direct control over the resources that is critical to attaining these goals and establishing this accountability. These executives, in turn, do not have an internal incentive structure that is so visibly active and seemingly effective among their New Zealand counterparts.

In DoD, a comparable though somewhat different environment exists among the acquisition program managers:

1. The short tenures of the PMs (who are predominantly military officers) reduce their ability to fully understand the business and technical complexities of their cognizant weapons acquisition program.
2. These officers' careers are tied directly to the success of the programs they manage (i.e., how quickly a weapons system is produced and ready for



operational use). There is a strong disincentive to candidly admit any performance shortcomings and present evidence of cost overruns, since this raises program visibility within DoD and Congress and forces the PM and his chain of command to work even harder to justify this program.

3. Congressional oversight and control of the budget introduces conflicting messages and incentives in the PM's fiduciary responsibilities. On the one hand, the PM is expected to control costs and maximize the value of the weapons system to the user and taxpayers; on the other hand, this same person is expected by everyone involved in the process to spend every available dollar and try to obtain more.[Ref. 2:pp.191-193; Ref. 5:pp.308-311]

The reader can note the obvious parallels between the environment facing the program manager and the theoretical budget-maximizing bureaucrat in Chapter II. Informed observers have correctly stated that the program manager has relatively little control over the resources and external influences that affect his or her ability to deliver a weapons system within the cost, schedule and performance parameters.[Ref. 33:p.8; Ref. 5:p.311; Ref. 6:p.7] This lack of resource control (i.e., no "property rights")

induces the program manager to act as a budget-maximizer with little regard for cost reduction and economic efficiency.

One remaining factor that warrants attention is the "sense of urgency" that has acted as a motivational force in the New Zealand and United States reform efforts. New Zealand's 1984 elections ushered in a group of like-minded senior Government officials who knew that radical reform was the only effective choice the country had in attempting to address the economic malaise. Likewise, the U.S. defense budget cuts that began in the late 1980s and accelerated with the Clinton administration created a similar sense of urgency among a group of reform-minded senior DoD officials. Secretary of Defense Les Aspin and his successor William Perry; Under Secretary of Defense (Acquisition and Technology) Paul Kaminski and his successor Jacques Gansler; and Office of Federal Procurement Policy (OFPP) Director Steven Kelman exemplify these reform advocates who have shepherded the reform process through many political and bureaucratic hurdles. The underlying concern, however, lies with the future: Once these individuals leave Government service (which may be sooner than later for the political appointees) will their successors have the same commitment to sustaining the reform initiatives? There are no systemic

incentives within the political process to ensure the availability of equally qualified and motivated individuals.

#### **F. CONCLUSION**

The United States and New Zealand have used distinctly different approaches to implementing reform initiatives, and it can be argued that these differences define the relative success (or lack thereof) of these reform efforts. New Zealand overtly incorporated incentive structures in a comprehensive and systematic reform program through contractual performance agreements with department heads and managers. These executives and managers were also given full authority over resource allocation decisions (subject to Government budget constraints) in fulfilling their performance measurements and outputs.

The United States appears to have used a more fragmented and incremental approach in its public sector reform programs, an outcome attributable to its unique form of Government that encourages dissent and adversarial relationships, fragmented control over resource allocation, and a diffusion of accountability. To borrow a phrase from former Secretary of Defense William Perry, the success that DoD has achieved in streamlining and improving its

acquisition processes has been in spite of the hodgepodge of Government-mandated reform initiatives, rather than because of them. [Ref. 26:p.8] By extension, one can argue that the omission of systemic, efficacious incentives at all levels of DoD, and the Federal Government as a whole, is a critical weakness that calls into the question the sustainability of public sector reform efforts in the United States.

The following chapter will present the conclusions and recommendations, answer the primary and secondary research questions, and provide recommended areas for further research.

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## VI. CONCLUSIONS AND RECOMMENDATIONS

### A. CONCLUSIONS

Acquisition reform initiatives over the past fifty years have either ignored or compromised the importance of economic incentives on the very people who have the primary responsibility for implementing these reform efforts, from the highest policy levels to the contracting specialist at a DoD procurement office. This disconnect between the goals and the realities of acquisition reform has led to recommendations that treat the symptoms, like cost overruns and performance shortcomings, rather than the basis for these problems.

Dr. Niskanen's economic theory of bureaucracy provides an analytical framework for understanding how important incentives are to the Government employees in the performance of their jobs and in their "budget-maximizing" behavior. This theory explains that in the absence of a profit motive and threat of competition, bureaucrats use survival techniques that motivate these individuals to pursue other than the least costly and most efficient means of achieving their agencies' goals and objectives.

A review of past acquisition reform efforts supports this theory. These efforts have contained the common themes of improving management controls, streamlining the acquisition process and enhancing the quality of the acquisition workforce. While these recommendations have considerable merit, a very basic and elementary question has been left out of the analysis: What are the incentives to the Government employees to embrace and implement these reforms, when they have little impact on their economic well-being? The panoply of reforms over the years has, in fact, bred an attitude of indifference and/or risk avoidance among many Government employees. Instead of effecting improvements, these reform efforts have actually exacerbated the behavior mechanisms described in the theory, with the resultant effect of enhancing the budget-maximizing incentives.

The National Performance Review has attempted to correct this deficiency by "empowering" acquisition employees to use commercial practices, apply innovative solutions in their jobs and manage risk rather than avoid it. The NPR would do so by eliminating bureaucratic rules, procedures and lines of authority that encumbered and demotivated these employees. The NPR also had planned on implementing civil service reforms to decentralize decision-

making authority and accountability to the lowest levels of the bureaucracy. Political opposition from labor unions and other interest groups scuttled this initiative early in the reform process. Nevertheless, the NPR has resulted in substantial changes in the acquisition process itself, including workforce educational improvements and the elimination of unpopular requirements and regulations. Workforce surveys demonstrate considerable support for a number of the acquisition reform initiatives. Whether these changes are self-sustaining, however, is a question that goes to the very core of the economic incentives argument. Congressional mandates to create effective incentive systems within the acquisition workforce have met with little substantial effort or enthusiasm from senior DoD officials.

Even though the NPR reformers recognized the importance of personnel reforms as an integral part of larger public sector reforms, the NPR's focus on cost savings as a means of securing and maintaining political support undermined the empowerment and motivating ideals that were crucial to its success. Dramatic personnel reductions - the largest quantifiable measure of these cost savings - created an even greater disincentive among Government employees in general, and the acquisition workforce in particular. Despite the popularity of some of the acquisition reform measures, the



general perception in the bureaucracy is that the end result of these initiatives in total is greater personnel reductions, with the predictable effect on motivation.

Government personnel reform efforts have echoed the pitfalls of past acquisition reform initiatives by also minimizing the impact of incentives within the bureaucracy. The Volcker Commission addressed the overt incentives of pay and career opportunities, but it appeared to ignore the systemic hurdles to rewarding achievement and penalizing poor performance. The NPR modeled much of its program on that of New Zealand's, but the lack of meaningful and effective civil service reform reduced much of its impact.

New Zealand has successfully embarked on and sustained one of the most ambitious public sector reform efforts in the world. It has a comprehensive program that recognizes and incorporates economic incentives as a fundamental element of the organizational structure. Performance contracts create an incentive based environment among the department heads and managers by tying output and performance measurements to economic awards and penalties, while granting them almost full authority over resource allocation decisions.

The United States has attempted a similar program through the Government Performance and Results Act, which

mandates the development and implementation of strategic management plans with quantifiable performance and outcome measurements. A critical link, however, is missing: The senior Government executives have no direct control over, or ownership interest in, the resources necessary to meet these outcome goals; nor is their job security threatened by any lack of compliance. The complexity of generating a plan for the Department of Defense is a significant obstacle, yet it appears that the responsible DoD officials are using few of the lessons from their own pilot programs to successfully implement this potentially valuable management tool. The lack of any incentives to do so may explain this lack of enthusiasm and admitted shortcomings that these same officials seem reluctant to correct.

The GPRA exemplifies the difficulties that the United States has in establishing effective and permanent public sector reforms. The built-in features of dissent and competing interests, as well as the Constitutional separation of powers (hence, different controls of the purse strings), present formidable obstacles to creating a comprehensive reform program that incorporates the critical incentive structures. Instead, the United States consistently uses incremental reform measures that may minimize political opposition, but do little to harness the

powerful forces of economic self-interest and utility maximization that are so vital for the efficient and cost-effective use of scarce resources.

The tangible achievements of the current acquisition reform efforts are primarily a result of the ascendancy of reform-minded senior DoD executives (all with substantial knowledge of, and experience in, DoD acquisition and logistics) who have advocated and directed the reform initiatives in an era of reduced defense spending. The problem lies, however, with the issue of sustainability: once this cadre of executives leaves Government service, there is no process and - more importantly - no incentive structures in existence that will ensure their successors continue the reform efforts without interruption.

## **B. ANSWERS TO RESEARCH QUESTIONS AND RECOMMENDATIONS**

### **1. What incentives currently exist within DoD that hamper or assist acquisition reform efforts?**

The incentives created by budget-maximizing behavior in any Government bureaucracy hamper any reform efforts, whether it is in DoD or any other Government agency. Job security and pay are directly related to the size of the agency's budget, which is a function of the agency's ability

to expand its scope of responsibilities and output (for goods or services). Reform efforts, in general, attempt to increase efficiency and economy within the Government, including potential reductions in personnel. These efforts may negatively affect the economic well being of the bureaucrat; therefore, the bureaucrat has no incentive to embrace and accept these reform efforts. An exception to this conclusion may occur when reform efforts eliminate some of the more burdensome and bureaucratic rules and regulations, as the current initiatives have done. In this case, the bureaucrat may accept these reforms because he sees no threat to his job, and it may, in fact, improve his promotion opportunities through incremental efficiency (and recognition) gains in the agency.

**2. How does the unique nature and status of governmental organizations affect the ability to instill commercial/pseudo-competitive business practices in these organizations?**

Government agencies are unique in that they (1) generally do not have to compete with other agencies or private firms; (2) have no profit motive; (3) have no threat of bankruptcy (or little threat of dissolution from Congress); and (4) attain their revenue from Congress. Consequently, they have no incentive to minimize costs or

maximize efficiency. Without an efficacious incentive structure to mitigate these budget-maximizing characteristics, instilling commercial type practices will most likely be very difficult, and, at best, marginally effective.

**3. Can the Government establish incentives within the Federal bureaucracy to motivate DoD acquisition professionals to sustain acquisition reform initiatives?**

New Zealand's 15 years of experience clearly proves that governments can design and implement comprehensive reform programs that incorporate critical incentive structures. One lesson to focus on, however, is the need to reform the personnel systems in conjunction with larger public sector programs. The restrictive civil service rules in place today protect poor performers at the expense of exceptional performers, creating disincentives for efficient labor resource allocation.

The nature of the United States Government presents a major obstacle to implementing these types of incentive structures, primarily because of the conflicting interests and diffusion of authority. The other problem is that this issue has not become a "crisis"; therefore, it is highly unlikely that the interested parties will be able to reach a

consensus to act. Nevertheless, Congress should expand upon the strategic management structure of the GPRA, and confer resource control to the DoD acquisition executives, which, in turn, would be linked with job security and performance bonuses. This change would create the incentive structures and accountability features necessary to ensure the optimal use of taxpayer resources.

### **C. AREAS FOR FURTHER RESEARCH**

1. How effective has the Defense Reform Initiative been in sustaining acquisition reform efforts?
2. How feasible is it to reform the United States Civil Service?
3. How successful have other public sector reform efforts been in the UK, Sweden, and Australia?
4. Have recent acquisition reform efforts resulted in any quantifiable cost savings, reduced procurement cycle time, and/or improvements in weapons systems performance?

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